

# Deterring the State versus the Firm: Soft and Hard Deterrence Regimes in EU Law

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*Abstract: This paper sheds light on the existence of a differential deterrence regime in EU law, depending on whether the State or the firm is the addressee of a legal obligation. To that end, we review two areas of EU law – environmental law and competition law. Both disciplines employ fines to deter the State and the firm respectively from violating their specific duties under the Treaty: the ‘duty to transpose’ with regard to State obligation under environmental law, and the ‘duty to compete’ in relation to firms under competition law. We show how the deterrence regime is softer on the State in at least three ways: functionally (purpose ascribed to the penalties), operationally (method followed to set and liquidate the penalty), and procedurally (requiring prior judicial approval as opposed to having immediate applicability). These findings are significant for two reasons: they suggest a State versus firm discrepancy in the EU’s deterrence regime, and serve to initiate a debate on the desirability of such a divide.*

## 1. Introduction

At a stylized level, European Union (‘EU’) policies transversally impose obligations on two types of economic agents: the State and the firm. Yet, the systems of penalties used to deter violations of EU law by the State and the firm markedly diverge.<sup>1</sup> Our study shows that when the State is the addressee, the system of deterrence is *softer*, be it functionally (purpose ascribed to the penalties), operationally (method followed to set the penalty), and procedurally (requiring prior judicial approval as opposed to immediate applicability). In contrast, under all similar counts, the firm is under a *harder* deterrence regime.

Over and above the key objective of showing that soft and hard deterrence regimes exist in EU law, this paper advances the somewhat controversial idea that such divergence between deterring the State and the firm may need a rethink. Whilst it is true that the State and the firm does not respond equally to incentives due to a variety of reasons outlined later in this study, it remains that both the State and the firm are, to a given extent, social organisations that respond to utility functions. What is more, the market discipline, to which firms are exposed, is a source

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<sup>1</sup> Schwarze notes that ‘Sanctions are a major policy instrument in the European Community’, see J. Schwarze, *Judicial Review of Administrative Procedure*, (2004) 68 *Law and Contemporary Problems*, 85.

of powerful deterrence incentives to which the State is not subject. As explained by Ronald Coase, although Government may be seen as a ‘super-firm’, it is not subject to checks in its operations as is the firm but is instead able, if it wishes, ‘to avoid the market altogether, which a firm can never do.’<sup>2</sup> This may be seen as calling for harder, not softer deterrence on the State. Whilst we fall short of reaching this conclusion, we nonetheless argue that this perspective invites further thinking on deterrence as applied vis-à-vis the State and on a requalification of the two-tier deterrence regime observed in the EU.

This is undoubtedly an ambitious paper, underpinned by broader questions of optimal enforcement of law on which there is no scholarly consensus. Moreover, deterrence is not the whole and sole enforcement strategy, and we recognise that many other effective strategies can be used by regulators to enforce the law.<sup>3</sup> That said, the ambition of this paper is *not* to discuss the pros and cons of optimal deterrence as a law enforcement strategy, but instead to illustrate and also better understand why, within the positive deterrence system followed in EU law, two distinct regimes co-exist depending on who the addressee of the legal obligation is. In this context, we acknowledge the explanatory force of the EU’s institutional design, which means that soft deterrence may not be a deliberate strategy but is to some extent endogenous to the way that the EU is constructed and operates. This may indeed create certain challenges in proposing revisions of the current system but it also makes the case for a rethink of the State/firm distinction.

Our analytical framework reviews deterrence policy in two specific areas of EU law: environmental law and competition law. At a conceptual level, both disciplines employ fines to

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<sup>2</sup> R. Coase, *The Firm, the Market and the Law* (University of Chicago Press 1990) 117. For an introduction, see U. Pagano, ‘Public Markets, Private Orderings and Corporate Governance’, (2000) 20 *International Review of Law and Economics* 453–477.

<sup>3</sup> For instance, and in the view of Gunningham, different intervention strategies – deterrence being one of them – ought to be applied in enforcing environmental law, see N. Gunningham, ‘Enforcing Environmental Regulation’ (2011) 23 *Journal of Environmental Law* 169, 194. More generally, Ayres and Braithwaite discuss a pyramid of enforcement strategies including persuasion, warning letters, enforcement notice, administrative penalties, criminal prosecution, license suspension and revocation, see I. Ayres and J. Braithwaite, *Responsive Regulation: Transcending the Deregulation Debate* (Oxford University Press 1992).

respectively deter the State and the firm from violating their respective duties under the Treaty: the ‘duty to transpose’ with regard to State obligations under environmental law, and the ‘duty to compete’ in relation to firms under competition law.<sup>4</sup> By resorting to fines, both sets of legal rules ultimately seek to avert sources of serious harm: environmental and consumer harm. As such, they constitute useful comparators. We study in particular how the Commission and the Court of Justice of the European Union (CJEU) interpret and impose financial sanctions on the State and firms in this context, focusing on enforcement actions brought by the Commission under Article 260 Treaty of the Functioning of the EU (TFEU) and Regulation 1/2003 respectively.<sup>5</sup>

We certainly appreciate that Article 260 TFEU is applicable in *all* areas of EU law and is, as such, not an enforcement mechanism specific to environmental law. Similarly, we acknowledge that environmental law delegates significant enforcement responsibility to private law remedies and Member States’ authorities, which are not covered in this study.<sup>6</sup> That said, we study how the State is deterred under Article 260 TFEU through the lenses of environmental law for two main reasons.

First, Article 260 TFEU is the only judicial remedy that can be used to financially sanction States for violations of their duty to transpose under the Treaties. It is for this reason, and not so as to argue that environmental law is only concerned with state action or public law<sup>7</sup> that we focus on this particular provision. Second, almost half of the existing case law on Article 260 TFEU deals with environmental law, and more precisely, with the failure of a Member State to transpose an environmental directive following a Court judgment under Article 258 TFEU, or to

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<sup>4</sup> The treaty talks of ‘undertakings’ to refer to organs that carry out an ‘economic activity’. From a conceptual standpoint, however, the notion of firm can be used as a synonym for undertaking.

<sup>5</sup> Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty (2003) L1/1, based on Articles 192(4), 101 and 102 TFEU.

<sup>6</sup> For a detailed overview, see M. Hedemann-Robinson, *Enforcement of European Union Environmental Law: Legal Issues and Challenges* (2 edn, Routledge 2015). In particular, the EU Environmental Liability, for instance, is another important instrument that is for the Member States to use in enabling direct civil claims by private parties against polluters, see L. Bergkamp and B. Goldsmith (eds), *The EU Environmental Liability Directive: A Commentary* (Oxford University Press 2013).

<sup>7</sup> Market/state dichotomy in this regard is challenged in S. Bogojević, *Emissions Trading Schemes: Markets, States and Law* (Hart Publishing 2013) chapter 6.

communicate to the Commission the measures adopted to transpose an environmental directive.<sup>8</sup> Environmental law thus seems to constitute a useful and representative vantage point to study the sanctions imposed to deter States from violating their duty to transpose.

Our framework focuses exclusively on financial penalties,<sup>9</sup> which, in line with deterrence theory, are the primary devices to unconditionally deter breaches of the law.<sup>10</sup> In contrast, we do not explore liability in tort as a possible deterrence device. In the literature, the objectives of tort liability have been said to remain a ‘mystery’, and deterrence is often described as a tangential objective of liability remedies.<sup>11</sup> Moreover, in practice, the empirical potential of liability remedies to ensure deterrence in environmental and competition law is limited.<sup>12</sup> In so far as Member States liability under *Francovich* is concerned, the track record of Member States non-transposition prior to the adoption of Article 260 TFEU empirically shows that liability remedies are ineffective at deterring breaches of the duty to transpose, and are at best a compensatory mechanism. In so far as firm liability for breaches of the duty to compete is concerned, it ought to be recalled that competition law infringements are often secret, thus making victim enforcement remedies ever inapt to deter.<sup>13</sup>

Finally, it should be noted that we use the generic concepts of State and firm to denote respectively for all State-related organizations on the one hand, and for all undertakings, which

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<sup>8</sup> See Section 2.

<sup>9</sup> Financial sanctions and fines are terms used interchangeably in this text, for a similar approach see C. Abbot, *Enforcing Pollution Control Regulation: Strengthening Sanctions and Improving Deterrence* (Hart Publishing 2009) 10.

<sup>10</sup> This approach is further explained in Section 6, focusing on Becker’s seminal work on deterrence, see G. Becker, ‘Crime and Punishment: An Economic Approach’ in Gary Becker and William Landes (eds), *Essays in the Economics of Crime and Punishment* (NBER 1974) 1.

<sup>11</sup> ‘This view of tort has fallen into disregard among most lawyers. They will argue that the cumbersome nature of the law and the impact of injurer ignorance about the law, insurance and the high costs and delays of litigation make it implausible that tort deters wrongful behaviour ... Thus it is implausible that this objective is overriding.’ C. Veljanovski, *Economic Principles of Law* (Cambridge University Press 2007) 183.

<sup>12</sup> It is indeed well known that rules on State liability are also predicated on the ambition to provide incentives to States and their agencies, see G. Dari-Mattiacci, N. Garoupa and F. Gomez-Pomar, ‘State Liability’ (2010) *European Review of Private Law*, 773-811. On State liability in EU law, see e.g. P. Aalto, *Public Liability in EU Law: Brasserie, Bergaderm and Beyond* (Hart Publishing 2011) chapter 6.

<sup>13</sup> Veljanovski (n 11) 241, 245.

discharge an ‘economic activity’ on the other hand. This interpretation is in line with the prevailing understanding in conventional EU law.<sup>14</sup>

The article is structured as follows. The two first sections analyse how the Commission and the CJEU apply the relevant rules to deter the State and the firm in EU environmental (2) and competition (3) laws. We show that in these instances, the function, operation, and procedure of deterrence is softer on the State than it is on the firm. We call this the two-tier deterrence hypothesis (4). We find that the State/firm dichotomy is in line with existing deterrence literature, which primarily focuses on the firm, and gives little attention to State deterrence. We argue, however, that to a certain degree, the State is a social organisation that falls within the framework of deterrence scholarship, thereby calling into question the current State/firm dichotomy (5). The article concludes with a discussion of possible items for future research (6).

## **2. Deterring the State: Environmental Law a Case Study**

Environmental protection is a key public policy of the EU. This is evidenced by a number of treaty provisions,<sup>15</sup> including Article 3(3) Treaty of the European Union (TEU), which provides that the Union shall ‘work for the sustainable development of Europe based on...a high level of protection and improvement of the quality of the environment.’ A similar wording is found in Article 37 of the now legally binding Charter on fundamental rights of the EU, which offers environmental protection in the EU legal context human rights significance.<sup>16</sup>

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<sup>14</sup> See e.g. P. Craig and G. de Burca, *EU Law: Text, Cases and Materials* (6 edn, Oxford University Press 2015) 206, 1003.

<sup>15</sup> E.g. Article 21 TEU makes reference to the EU’s external environmental competences, Article 11 TFEU sets out the integration principle, Title XXI extends the EU’s influence to the energy sector and Article 114(3) obliges the Commission to consider environmental protection in its legislative proposals. For an overview, see H. Vedder, ‘Treaty of Lisbon and European Environmental Law and Policy’ (2010) 22 *Journal of Environmental Law* 285.

<sup>16</sup> S. Bogojević, ‘EU Human Rights Law and Environmental Protection: The Beginning of a Beautiful Friendship?’ in S. Douglas-Scott and N. Hatzis (eds), *EU Human Rights Law* (Edward Elgar 2016 forthcoming).

It may seem obvious that EU environmental law is concerned with environmental problems.<sup>17</sup> However, historically at least, the EU rules on environment were equally, if not more, concerned with the elimination of obstacles to the rolling out of the internal market. Many secondary legislation instruments related to the environment were enacted on the basis of internal market provisions with the aim of ironing out disparities in national legislation, which caused differences in conditions of competition and, as a result, undermined market integration.<sup>18</sup> The discipline, however, has undergone a vibrant evolution and morphed into a public policy of its own – although its legal context, or more precisely, the internal market, inevitably affects the type of laws that are enacted. As such, the EU has proved a key player in using some of its environmental competences to legislate across a wide range of environmental issues, including managing air pollution, biodiversity and waste, as well as establishing procedural safeguards, such as environmental impact assessment, access to justice and environmental information, and public participation in environmental decision-making.<sup>19</sup>

In terms of the number of legal instruments in place, EU environmental law is a densely populated subject.<sup>20</sup> Those instruments generally come in the form of directives that require domestic implementation.<sup>21</sup> However, the transposition is often far from effective. As explained by Wennerås, the most persistent problem in EU environmental law ‘is not the absence of adequate laws, but the flawed and belated Member State transposition, as well as insufficient application and enforcement of those rules’.<sup>22</sup>

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<sup>17</sup> Although defining the relevant ‘laws’, ‘environmental problems’ and aims and objectives of solutions is deeply complicated, see E. Fisher, B. Lange and E. Scotford, *Environmental Law: Text, cases, and materials* (Oxford University Press 2013) chapters 1-3.

<sup>18</sup> Bogojević, *Emissions Trading Schemes* (n 7) 72.

<sup>19</sup> See M. Lee, *EU Environmental Law, Governance and Decision-Making* (2 edn, Hart Publishing 2014).

<sup>20</sup> For an overview, see J. Jans and H. Vedder, *European Environmental Law - After Lisbon* (4 edn, Europa Law Publishing 2011).

<sup>21</sup> M. Peeters and R. Uylenburg (eds), *EU Environmental Legislation: Legal Perspectives on Regulatory Strategies* (Edward Elgar Publishing 2014) Part 2.

<sup>22</sup> P. Wennerås, *The Enforcement of EC Environmental Law* (Oxford University Press 2007) 1-2.

Almost equally, Member States convictions by the European Court of Justice (ECJ) for failure to comply with EU environmental law, including environmental directives, call for transposition. In order to induce the Member States to observe their duty to transpose in this regard, financial sanctions were introduced in the Maastricht Treaty, now codified in Article 260 TFEU, vesting the Commission with enforcement power.

### **A. Deterrence and Article 260 TFEU**

At its core, the underlying objective of Article 260 TFEU is to deter Member States from breaching their ‘duty to transpose’. We use here the concept of ‘duty to transpose’ in the sense of the failure of a State (i) to transpose an environmental directive following a Court judgment under Article 258 TFEU *or* (ii) to communicate the measures adopted to transpose a directive to the Commission. In this context, financial sanctions are deemed ‘the most appropriate instrument’.<sup>23</sup> Pursuant to Article 260 TFEU two types of fines can be imposed: penalty payments and lump sum fines.

More precisely, Article 260(1) TFEU prescribes that a Member State found in breach of EU law by the ECJ must take necessary measures to implement the judgment. Shirking on this may lead to penalties issued by day of delay after the delivery of the judgment, and/or a lump sum sanctioning the continuation of the infringement after the initial judgment making a finding of infringement.<sup>24</sup> It is on this premise, and based on Article 260(2) TFEU, that the Commission may refer the matter for a second time to the ECJ and in doing so, specify the amount of the penalty payment and/or lump sum to be paid by the Member States in question. The Court

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<sup>23</sup> Commission Communication on the Application of Article 228 EC, SEC(2005) 1658, para. 10.

<sup>24</sup> Ibid para. 10.3. The Court may also issue that the penalty payments are to be paid in monthly, quarterly or annual instalments see Section 2(B).

enjoys full discretion on the penalty payment and/or lump sum to be imposed on the infringing Member State. As such, the Court is not bound by the Commission's penalty recommendations.<sup>25</sup>

The Lisbon Treaty added a third limb to this article, Article 260(3) TFEU. This provision deals with a distinct breach of the duty to transpose. In EU law, Member States are under a general obligation to report to the Commission on the steps taken to implement EU legislation. Article 260(3) TFEU seeks to give some teeth to this obligation, by introducing sanctions for failure to notify measures transposing a directive adopted under a legislative procedure. The rationale behind this provision is to soothe the endemic problem of omitted, delayed or inappropriate implementation of EU legislation by the Member States.<sup>26</sup> In such instances, the Commission may bring a case to the ECJ, specifying the amount of the lump sum or penalty payment to be paid by the Member State concerned that it considers appropriate in the circumstances. If the Court finds that there is an infringement, it may impose financial sanctions but these, in contrast to the wording of Article 260(2) TFEU, may not exceed the amount specified by the Commission.

This brief outline of Article 260 TFEU highlights at least two important points regarding deterrence against the State under EU law. First, it is conditioned on prior judicial approval. In the case of Article 260(2) TFEU, two rounds of legal proceedings are necessary: first, an initial Court finding of infringement of a Treaty obligation, which the ECJ has ruled refers to finding of an infringement under Article 258 TFEU;<sup>27</sup> and second, a Court finding of infringement of the duty to transpose its initial judgment. Article 260(3) TFEU also requires prior judicial approval but cases are dealt with at once by the Court. Article 260 TFEU proceedings are, in practice,

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<sup>25</sup> More precisely, the Court makes clear that, in this regard 'the Commission's suggestions cannot bind the Court and are merely guidance...[and] may contribute to ensuring that the Commission's actions are transparent, foreseeable and consistent with legal certainty.' Case C-533/11 *Commission v Belgium* [2013] nyr para. 52.

<sup>26</sup> Commission Communication, Implementation of Article 260(3) TFEU, SEC(2010) 1371 final, 4.

<sup>27</sup> According to the CJEU, the failure by a Member State to fulfil its obligations under the Treaty can be dealt with under Article 260(2) TFEU only in relation to infringements that the Court, ruling on the basis of Article 258 TFEU, has already established', see Case C-196/13 *Commission v Italy* [2014] nyr, para. 32.

cumbersome. This may explain that penalties are only rarely imposed on States, and in many instances only as a final resort.

Second, Article 260 TFEU cases are primarily about the failure to ‘transpose’ EU text or case law. With this seemingly obvious remark, we want to stress that Article 260 TFEU purports to end breaches of EU law in specific cases, no more. The Court says just this when it states that Article 260(2) TFEU is a ‘special judicial procedure, peculiar to Community law’ that is ‘not intended to compensate for damage caused by the Member State concerned, but to place it under economic pressure which induces it to put an end to the breach established.’<sup>28</sup>

This is not to say that Article 260 TFEU does not pursue a deterrence goal. The Commission has indeed stressed the need to ensure the ‘appropriate *amount*’ of financial sanctions ‘in order to ensure their *deterrent effect*.’<sup>29</sup> It was backed by the Court, which held that it shall set financial penalties according to ‘the degree of persuasion and deterrence’ that appears to be required, and so as to *prevent* ‘similar infringements of EU law’,<sup>30</sup> or even ‘the *recurrence* of similar infringements of EU law’.<sup>31</sup> However, such statements remain overall rare in the case law,<sup>32</sup> and they seem to concern only the imposition of lump sums. The following sections will also elucidate our overall argument that although deterrence is an inherent part of Article 260 TFEU, its application on the State is soft and one that encourages cooperation instead of compulsion.

## **B. Sanctions for Non-Implementation of an ECJ Judgment**

The possibility of imposing fines for the failure to implement an ECJ judgment pursuant to Article 260(2) TFEU was, as mentioned earlier, introduced in the Maastricht Treaty but it took

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<sup>28</sup> Case C-304/02 *Commission v France* [2005] ECR I-06263, para. 91. Similar wording *ibid*.

<sup>29</sup> SEC(2005) 1658, para. 8.

<sup>30</sup> Case C-279/11 *Commission v Ireland* [2012] nyr, para. 66.

<sup>31</sup> *Commission v Italy* (n 27), para. 86. Emphasis added.

<sup>32</sup> Similar formulations are found in Case C-374/11 *Commission v Ireland* [2012] nyr, para. 48, and Case C-653/13 *Commission v Italy* [2015] nyr, para. 65.

eight years for this provision to be put into practice.<sup>33</sup> Since then, Article 260(2) TFEU has been only occasionally used.<sup>34</sup> Almost half of the existing case law deals with judgments concerning the failure to transpose environmental directives,<sup>35</sup> and more precisely, directives on waste,<sup>36</sup> integrated pollution prevention control,<sup>37</sup> urban waste-water treatment,<sup>38</sup> environmental impact assessment,<sup>39</sup> inshore bathing water,<sup>40</sup> common fisheries policy,<sup>41</sup> and the deliberate release of genetically modified organisms.<sup>42</sup> Failure to transpose environmental directives may occur in three ways: non-transposition of the directive into national law; actual, but incorrect, transposition of the directive; actual and correct transposition of the directive, but non-implementation.<sup>43</sup> As previously explained, the sanctions that may be imposed in such cases are periodic penalty payments and fines in lump sum. The Court tends to consider them in this order, although this is not always the case.<sup>44</sup> Overall, a wide discrepancy exists in the jurisprudence on how sanctions are calculated and which considerations are relevant for the Court to consider in this regard. We show this next, discussing penalty payments and fines in lump sum in turn.

### (i) Penalty Payments

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<sup>33</sup> For a historical overview of Article 260(2) TFEU see I. Kilbey, 'Financial Penalties under Article 228(2) EC: Excessive Complexity?' (2007) 44 *Common Market Law Review* 743.

<sup>34</sup> At the time of writing, (9<sup>th</sup> of November 2015), the ECJ has relied on what is today Article 260 TFEU in a total of twenty-nine cases. Similar observation of the scarce application of Article 260 TFEU is noted in P. Wennerås, 'Sanctions against Member States under Article 260 TFEU: Alive, but not kicking?' (2012) 49 *Common Market Law Review* 145.

<sup>35</sup> In 2014, out of a total of five Court judgments under Article 260(2) TFEU, three were concerned with environmental law. These include *Commission v Italy* (n 27), Case C-378/13 *Commission v Greece* [2014] nyr, and Case C-243/13 *Commission v Sweden* [2014] nyr. Of the total of twenty-nine cases noted *ibid*, twelve are concerned with environmental law; that is, almost half the relevant jurisprudence.

<sup>36</sup> *Commission v Italy* (n 27), *Commission v Greece* (n 35), *Commission v Ireland* (n 30), Case C-387/97 *Commission v Greece* [2000] ECR I-05047, *Commission v Italy* (n 32), Case C-167/14 *Commission v Greece* (no 3) nyr.

<sup>37</sup> *Commission v Sweden* (n 35).

<sup>38</sup> *Commission v Belgium* (n 25), Case C-576/11 *Commission v Luxembourg* [2013] nyr.

<sup>39</sup> *Commission v Ireland* (n 30).

<sup>40</sup> Case C-278/01 *Commission v Spain* [2003] ECR I-14141.

<sup>41</sup> *Commission v France* (n 28).

<sup>42</sup> Case C-121/07 *Commission v France* [2008] ECR I-09159.

<sup>43</sup> As described in Fisher and others, *Environmental Law* (n 17) 143-144.

<sup>44</sup> In *Commission v Belgium* (n 25), for instance, the Court first examines lump sum and then penalty payments.

Penalty payments seek to prompt Member States to end the infringement of their obligations. Accordingly, in *Commission v France*, where the Member State had complied with the original judgment in its entirety by the time the Article 260 TFEU-based case reached the CJEU docket, the imposition of a penalty payment was no longer deemed necessary.<sup>45</sup> Moreover, the Court has repeatedly affirmed that the amount of penalty payment to be paid was predicated on the ambition to ‘induce’,<sup>46</sup> ‘encourage’<sup>47</sup> and ‘persuade’<sup>48</sup> the defaulting Member State to bring to an end the infringement in question. In brief, penalty payments are only ordered when an infringement persists.

The calculation of the appropriate amount of the penalty is based on three main parameters. The Court considers the duration of the infringement, its degree of seriousness and the ability of the Member State concerned to pay.<sup>49</sup> These criteria are similar to those found in Guidelines issued by the Commission, whereby an initial flat-rate amount of EUR 640 per day is multiplied by: (i) a coefficient for seriousness on a scale of 1 to 20; (ii) a coefficient for duration on a scale of 1 to 3; and (iii) a fixed amount, ‘the n factor’, reflecting both the Member State’s capacity to pay and the number of votes it has in the Council of the EU.<sup>50</sup>

In the Commission’s guidelines, the deterrence function of penalty payments is clearly expressed. The Commission explains that the imposition of periodic payments serves not only to ensure that the Member State brings the infringement to an end but also that it does not repeat the same offence.<sup>51</sup> To reach that deterrent effect, the Commission makes clear that the amount

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<sup>45</sup> Ibid para. 28. The Court, however, ordered a lump sum to be paid. See also *Commission v Luxembourg* (n 38) para. 43, and *Commission v Sweden* (n 35) para. 47.

<sup>46</sup> *Commission v Italy* (n 27) para 94.

<sup>47</sup> *Commission v Spain* (n 40) para. 42.

<sup>48</sup> *Commission v Italy* (n 27) para. 96.

<sup>49</sup> E.g. *Commission v Luxembourg* (n 38) para. 47, *Commission v Belgium* (n 25) para. 69, *Commission v Italy* (n 27) para 97. In *Commission v Spain* (n 40) para. 52, *Commission v Sweden* (n 35) para. 51.

<sup>50</sup> See Commission Communication on the Application of Article 260 TFEU. Up-dating of data used to calculate lump sum and penalty payments to be proposed by the Commission to the Court of Justice in infringement proceedings, SEC (2010) 923/3.

<sup>51</sup> Ibid para. 18. This is calculated by taking the gross domestic product (GDP) of the Member State into account and weighing the voting rights in the Council of the Member State.

of the periodic payments must outweigh the benefits that the Member State derives from the infringement.<sup>52</sup>

In practice, the Court has tended to follow these guidelines (though with repeated reminders that it is not bound by them).<sup>53</sup> Its methodology in doing so, however, is inconsistent. For instance, in some cases, it lists the mentioned criteria but then turns a blind eye on them.<sup>54</sup> In contrast, in other cases, it applies them but it enriches them from other considerations, such as whether the penalty payment is both appropriate to the circumstances and proportionate to the infringement established and the ability of the Member State concerned to pay,<sup>55</sup> as well as having regard to the effects on public and private interests of failure to comply and to the urgency with which the Member States concerned must be induced to fulfil its obligations.<sup>56</sup> Its wide discretion in doing so makes the method of determining penalty payments difficult to predict. Yet a salient trend in the evolution of the Court's case law is its proclivity to make space to *bona fide* cooperation defences invoked by infringing States, this despite the fact that the wording of Article 260(2) TFEU does not provide for any line of excuse.<sup>57</sup>

Let us sift in more detail through the three criteria. On the first criterion – the ‘seriousness’ of any environmental law infringement – the Court tends to link the relevant environmental law breach to Article 191 TFEU, which sets out the key objectives of EU environmental policy. From this perspective, it then can derive the importance of environmental protection as a public policy, which tends to lead it to the conclusion that harm to the environment is ‘particularly serious.’<sup>58</sup> On this point, the Court does not seem to accept any excuses.

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<sup>52</sup> Ibid.

<sup>53</sup> *Commission v Greece* (n 36) para. 89, *Commission v Italy* (n 32) para. 72.

<sup>54</sup> See for instance *Commission v Sweden* (n 35) paras. 51-60.

<sup>55</sup> *Commission v Greece* (n 35) para. 52. See also *Commission v Sweden* (n 35) para. 50, *Commission v Italy* (n 27) para. 96.

<sup>56</sup> *Commission v Luxembourg* (n 38) para. 47.

<sup>57</sup> Still it recognises the ‘right of defence that the Member State concerned must be able to exercise’. The Court labels these ‘procedural guarantees’, see *Commission v France* (n 28) paras 92-93.

<sup>58</sup> *Commission v Italy* (n 27) para. 98. See also *Commission v Greece* (n 35) para. 54.

On the second criterion, that is duration of the infringement, the Court tends to take the view that the longer that the infringement has been allowed to persist, the more serious the breach.<sup>59</sup> Any signs of collaboration in transposing EU law may, however, account as a mitigating factor. The court explains that ‘a penalty which does not take account of the progress which a Member State may have made in complying with its obligations is neither appropriate to the circumstances nor proportionate to the breach which has been found.’<sup>60</sup> By the same token, inaction on the part of Member States in taking steps to put an end to its infringement of EU law tends to be seen as an aggravating factor in the Court’s calculation of fines.<sup>61</sup>

Finally, in terms of the capacity of the Member State concerned to pay, the Court deems it necessary to take account of recent trends in a Member State’s gross domestic product at the time of the Court’s examination of the facts.<sup>62</sup> Its case law displays leniency towards Member States that face difficulties in times of macro-economic hardship.<sup>63</sup> In *Commission v Greece*, for instance, the Court stated that ‘it is appropriate to take account of the Hellenic Republic’s argument that its GDP has declined since 2010’, or more broadly, recent trends in the GDP of a Member State at the time of the Court’s examination of the facts.<sup>64</sup> Based on these factors, it decreased the penalty payment suggested by the Commission to be imposed on the Member States.

Besides this crude three-pronged method for the setting of periodic penalties, Member States have also sought to challenge periodic payments on grounds of more general arguments. Often, the Court has seemed reluctant to give currency to such defences. For instance, the Court has made clear that, in line with classic EU case law, complexity of implementation or internal

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<sup>59</sup> Most of these cases deal with long-term infringements. Ireland, for instance, was found after 19 years still not to have complied with its obligations, see *Commission v Ireland* (n 32) para. 38. In *Commission v Italy* (n 27) the infringement has persisted for more than seven years.

<sup>60</sup> *Commission v Spain* (n 40) para. 49. See also *Commission v Ireland* (n 32) para. 39-42. In *Commission v Luxembourg* (n 38) para. 55, the Court makes the note that the penalty payment needs to be proportionate to the share of its obligations carried out. Similar point in *Commission v Belgium* (n 25) para. 70.

<sup>61</sup> See *Commission v Italy* (n 32) para. 78.

<sup>62</sup> *Commission v Italy* (n 27) para. 104.

<sup>63</sup> *Commission v Ireland* (n 32) para. 44, See also *Commission v Greece* (No 3) (n 36).

<sup>64</sup> *Commission v Greece* (n 35) para. 58.

difficulties in ensuring implementation cannot be taken into consideration. On this point, the Court explains that ‘Member States cannot plead provisions, practices or situations prevailing in its domestic legal order to justify the failure to observe obligations arising under European Union Law’<sup>65</sup> – a view it has confirmed in recent case law.<sup>66</sup>

In *Commission v Sweden*, the Court even went as far as to consider that a Member State could not invoke constitutional issues for failing to implement an environmental directive on time. In the case in point, Sweden deemed it impossible to fasten the process of issuing authorisation to installations for their industrial activities, as required by the Integration Pollution Prevent Control (IPPC) directive, due to its constitution that requires judicial preapproval for such an authorisation process.<sup>67</sup> Although the court dismissed this general defence, and found that a penalty payment could not be excluded on such ground, it took cooperation with the Commission in the pre-litigation phase into consideration in the calculation of the fine. The fact that Sweden had failed to issue authorisation permits in respect of only two out of twenty-nine installations, which, the parties agreed, meant that Sweden’s non-compliance had limited effect on the environment and human health, also had a bearing on the Court’s calculation of penalty payment.<sup>68</sup> In light of this, the court almost halved the suggested fine.<sup>69</sup>

In terms of the final penalties ordered by the ECJ, there is variance both in the level of fines imposed and the instalments of their payment. Penalties ordered range from €2,800 to €120,000<sup>70</sup> to be paid on a daily or even annual basis until the date on which the Member State complies with the original judgment.<sup>71</sup> The court may also order specific sums to be deducted

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<sup>65</sup> *Commission v Ireland* (n 32) para. 39.

<sup>66</sup> *Commission v Italy* (n 32) para. 39, *Commission v Greece* (n 35) para. 29.

<sup>67</sup> *Commission v Sweden* (n 35) para. 53.

<sup>68</sup> *Ibid* paras. 54-58.

<sup>69</sup> The initial penalty payment was issued at €14912 and reduced to €7456 per day until the initial judgment is implemented.

<sup>70</sup> *Commission v Luxembourg* (n 38), *Commission v Italy* (n 32) respectively.

<sup>71</sup> For instance, in *Commission v Belgium* (n 25) the Member State was ordered to pay a fine of €4,722 for each day of delay in adopting measures necessary to ensure compliance with the original judgment; in *Commission v France* (n 28) the Member State was ordered to pay €57,761,250 for each period of six months from delivery of the present judgment until the original judgment has not been complied with; while in *Commission v Spain* (n 40) the Member State was ordered to pay €624,150 per year.

from the overall fine in line with the Member State's progress in implementing environmental law.<sup>72</sup> This type of flexibility offered to the Member States may be regarded as soft deterrence. All payments are directed to the European Union own resources.

## **b) Lump Sums Fines**

Whereas penalty payments seek to induce Member States to end to an on-going infringement, lump sum fines are ordered with a view to prevent the 'future repetition of similar infringements of European Union law'.<sup>73</sup> Lump sums may thus be ordered regardless of whether the infringement has ceased by the time of the judgment.<sup>74</sup> The Court sees lumps sum as particularly apposite where a Member State *repeatedly* engages in unlawful conduct. This is thought to call for a 'dissuasive measure', such as the imposition of a lump sum payment, so as to effectively prevent 'future repetition of similar infringements of EU law'.<sup>75</sup>

The Court resorts to factors similar to those taken in consideration for penalty payments in determining the size of the lump sum; that is, seriousness of the infringement, duration of the breach in question, and conduct of the Member State in breach.<sup>76</sup> In applying these criteria, it considers the effects of the infringement on public and private interests.<sup>77</sup> The Court, however, is as inconsistent in its methodology in determining lump sums fines as it is in setting penalty payments. Although it tends to adhere to the three criteria, at times, it refers to these as mere

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<sup>72</sup> For instance in *Commission v Greece* (n 35) the Member State was order to pay a total sum of €14,520,000, from which €40,000 to be deducted in respect of each uncontrolled waste disposal site, and €80,000 to be deducted in respect of each such site that has been both closed down and cleaned.

<sup>73</sup> *Commission v Ireland* (n 30) para. 70. Similar wording in *Commission v Italy* (n 27), para. 116, *Commission v Belgium* (n 25) para. 61.

<sup>74</sup> *Commission v France* (n 42).

<sup>75</sup> *Commission v France* (n 42) para. 60, and similarly in *Commission v Italy* (n 27) paras. 89-91 and *Commission v Sweden* (n 35) para. 63. In the latter case, the mention of deterring the 'breach of EU law' is specifically spelled out.

<sup>76</sup> *Commission v Belgium* (n 25) para. 53, *Commission v Italy* (n 27) para. 118.

<sup>77</sup> *Commission v Luxembourg* (n 38) para. 57. Similar wording in *Commission v France* (n 42) para. 64, *Commission v Greece* (n 35) para. 72.

‘considerations’,<sup>78</sup> suggesting that their application is not compulsory, or it lists the criteria but fails to explain how they apply in reaching the final lump sum fine.<sup>79</sup> In other instances, the Court explains that it considers not only the three criteria but ‘*all* the relevant factors pertaining to both the particular nature of the infringement established and the individual conduct of the Member State involved in the procedure instigated pursuant to Article 260 TFEU’<sup>80</sup> in the fixing of the amount of the lump sum. Determining lump sum fines is thus an act of wide judicial discrepancy.

Returning to the three criteria, it is worth mentioning that in examining the seriousness of the infringement is concerned, the Court makes clear that where failure to transpose one of its judgments is likely to harm the environment, there is a breach of ‘particularly serious’ nature. The ECJ considers that environmental protection is one of the European Union’s key policy objectives, as is apparent from Article 191 TFEU.<sup>81</sup> With regard to duration, the fact that an infringement has been allowed to persist seems sufficient to order a lump sum. This was the case in *Commission v Luxembourg*.<sup>82</sup> As far as the conduct of the infringing Member State is concerned, considerations taken into account by the Court include whether the State has cooperated with the Commission in the pre-litigation stage. Here, considerable efforts, or any concrete steps that the Member States may have taken to ensure compliance (showing the will to ‘cooperate in good faith’<sup>83</sup>) with the original judgment are favourably included in the Court’s calculation.<sup>84</sup> Thus cooperation is a mitigating factor – similarly to repeated violations<sup>85</sup> or inaction being an aggravating factor<sup>86</sup> – also in calculating lump sum fines.

With regard to the availability of defences, the Court is clear on the point that any political,

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<sup>78</sup> *Commission v Greece* (n 35) para. 76. Also, here, the Court fails to mention the third criterion found elsewhere in its jurisprudence on the application of lump sums, that is, ‘the Member State’s ability to pay.’

<sup>79</sup> *Commission v Sweden* (n 35), paras. 61-67.

<sup>80</sup> *Commission v Luxembourg* (n 38) para. 58. Emphasis added.

<sup>81</sup> *Commission v Belgium* (n 25) para. 56. Similar wording in *Commission v France* (n 42) paras. 77-78, *Commission v Ireland* (n 30) para. 72.

<sup>82</sup> *Commission v Luxembourg* (n 38) para. 65.

<sup>83</sup> *Commission v France* (n 42) para. 86.

<sup>84</sup> *Commission v Luxembourg* (n 38) paras. 62-63, See e.g. *Commission v France* (n 42) para. 85-86.

<sup>85</sup> *Commission v Italy* (n 27) para 115-116, *Commission v Italy* (n 32) paras. 74-80, 90.

<sup>86</sup> *Commission v Italy* (n 32) paras. 74-80, 91.

or internal circumstances delaying the adoption of the measures in question is not accepted. More precisely, it states that ‘a Member State cannot plead provisions, practices or situations prevailing in its domestic legal order to justify failure to observe obligations arising under European Union law.’<sup>87</sup> This meant that France could not rely on social unrest in failing to implement directives on GMOs.<sup>88</sup> With regard to economic difficulties that Member States may face in implementing EU environmental law, the Court tends to show more sympathy. In *Commission v Ireland*, Ireland contests *inter alia* the methodology used by the Commission to calculate the value of ‘n’, corresponding to Ireland’s ability to pay.<sup>89</sup> The Court, without much elaboration, accepted this as a diminishing factor in establishing the lump sum.<sup>90</sup>

The lump sum that have to date been ordered span over €1,5 million,<sup>91</sup> €2 million,<sup>92</sup> €10 million,<sup>93</sup> €20 million<sup>94</sup> to €40 million<sup>95</sup> imposed on the state in question to pay.

### C. Fines for Non-Communication

Article 260(3) TFEU fines sanction Member States that do not communicate to the Commission the measures adopted to transpose EU directives. As such, Article 260(3) TFEU is not about the duty to transpose, but about the duty to communicate. However, as the Commission noted, the duty to communicate is a variant of the duty to transpose effectively EU legislation:

The purpose of [Article 260(3) TFEU] is to give a stronger incentive to Member States to transpose directives within the deadlines laid down by the legislator and hence to ensure that Union legislation is genuinely effective...this is not only a matter of safeguarding the general interests pursued by Union legislation...but also and above all of protecting

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<sup>87</sup> *Commission v Ireland* (n 30) para. 71.

<sup>88</sup> *Commission v France* (n 42) para. 72.

<sup>89</sup> *Commission v Ireland* (n 30) para. 42.

<sup>90</sup> *Commission v Ireland* (n 30) paras. 78-79. The economic crisis was taken into account as a mitigating factor also in *Commission v Ireland* (n 32) para. 52 and *Commission v Greece* (no 3) (n 36).

<sup>91</sup> *Commission v Ireland* (n 30).

<sup>92</sup> *Commission v Ireland* (n 32) para. 52, *Commission v Luxembourg* (n 38) para. 67, *Commission v Sweden* (n 35) para. 66.

<sup>93</sup> *Commission v Belgium* (n 25), *Commission v Greece* (n 35), *Commission v France* (n 42), *Commission v Greece* (No 3)(n 36).

<sup>94</sup> *Commission v France* (n 28), *Commission v Italy* (n 32).

<sup>95</sup> *Commission v Italy* (n 27).

European citizens who enjoy individual rights under such legislation. Ultimately, it is the credibility of Union law as a whole.

According to the Commission financial sanctions are only effective if fixed at a level that is able to ensure the deterrent effect of the sanction. As such, ‘purely symbolic penalties’ are seen to ‘render this instrument useless and run counter to the objective of ensuring that directives are transposed within the time limits laid down.’<sup>96</sup> To reach an effective level, the Commission seems to rely on criteria similar to those applied under Article 260(2) TFEU.

At the same time, a spirit of cooperation equally seems to permeate Article 260(3) TFEU fines. The Commission stresses, for instance, that ‘in line with the principle of sincere cooperation’, a Member State that indicates that it has partially failed to notify measures will be allowed ‘mitigating circumstance leading to a lower coefficient for seriousness’ compared to case of complete failure to notify measures.<sup>97</sup> The need to cooperate to make EU laws effective thus clearly underpins also Article 260(3) TFEU.

Moreover, and in spite of the relatively limited track record of the Commission under Article 260(3) TFEU – no judgment has yet been delivered on this provision – the Commission has confirmed in practice that cooperation was the purpose of Article 260(3) TFEU. All cases brought under Article 260(3) TFEU since 2011 have in the meantime been withdrawn from the Court due to complete transposition.<sup>98</sup> In this way, Article 260(3) TFEU comes close to periodic payments adopted pursuant to Article 260(2) TFEU, that seek primarily to end on-going infringements.

## **D. Summation**

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<sup>96</sup> Ibid para. 15.

<sup>97</sup> Ibid para. 25.

<sup>98</sup> Ibid para. 20.

The case law above evidences that Article 260 TFEU is used as a tool designed to initiate cooperation in transposing EU law. As such, any deterrence used on the State is soft. This is obvious on several points, including the calculation of fines. Here, the Court tends to follow the Commission's criteria, albeit with wide discrepancy, taking into consideration three key factors (seriousness of the infringement, duration and the ability of the Member State to pay – including its votes in the Council), as well other considerations, such as, the effects on public and private interests, and conduct by the Member State. Although the Court's methodology in calculating fines is somewhat erratic, it is geared favourably toward cooperation. This means that infringements that persist over long periods of time tend to signal the need for heavy sanctions, whilst signs of cooperation in trying to end the breach mitigate such calculations, as does any economic difficulty that the defaulting Member States may evidence.

The fact that cooperation underlies Article 260 TFEU is also clear from the infringements it covers: non-transposition of ECJ judgments under Article 258 TFEU, and non-communication to the Commission of transposition measures. Any deterrence applied in this context is with the aim to coerce the State back to cooperating in transposing directives and case law. This has implications for the type of penalties available to the Court. For instance, Member States can avoid penalty payments if they comply with the initial judgment by the date of the second round of litigation.<sup>99</sup>

The Commission raised a valuable objection to this narrow scope of fines in *Commission v Sweden*. It demanding that any excess pollution emitted due to the Member State's failure to comply with EU environmental law, as well as any competitive advantage enjoyed by the relevant industries need to be accounted for in fines imposed.<sup>100</sup> What the Commission, in brief, seemed to ask for is a punitive and not mere cooperation-motivated fining system. Although the Court

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<sup>99</sup> A point made also by Wennerås (n 34) 162.

<sup>100</sup> *Commission v Sweden* (n 35) para. 39.

imposed financial sanctions on the Member States in this case, it did not acknowledge the Commission's mentioned remark.

To date, the Court imposed its highest fines in two separate cases against Italy: one in which a deductible penalty payment of €120,000 for each day of delay in adopting measures necessary to ensure compliance with the original judgment was imposed,<sup>101</sup> and the other, in which a record of €40 million in lump sum was ordered.<sup>102</sup> These are indisputably hefty sums but they were ordered to end infringements concerning hazardous waste, which present a high level of danger to human health and the environment and, which, in the latter case, had been a general and persistent breach located in almost every Italian region for a period of more than seven years. The longest, persisting breach, however, was found in *Commission v Ireland*, where the Member State had failed to comply with EU waste law for more than nineteen years. Ireland was ordered to pay a penalty payment of €12,000 for each day of delay in complying with the relevant judgment and a lump sum of €2 million.<sup>103</sup> This suggests that sanctions imposed on the State are the final resort in ensuring that infringements are put to an end. Even if at first glance they may appear high, they are dwarfed by fines imposed on firms in competition law – as we show later.<sup>104</sup>

Lastly, deterrence on States under Article 260 TFEU may be seen as soft also as it may only be imposed following long, evidentiary requirements of legal proceedings.<sup>105</sup> As such, it severely limits the Commission in pursuing environmental law breaches. In part this is due to the procedural limitations of Article 260(2) TFEU, or as the Court explains in *Commission v Luxembourg*: the Commission may only rely on this provision if its complaints are 'identical in fact and in law to those put forward in the [first] case'.<sup>106</sup> This, together with the high costs and long

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<sup>101</sup> *Commission v Italy* (n 32).

<sup>102</sup> *Commission v Italy* (n 27).

<sup>103</sup> *Commission v Ireland* (n 32).

<sup>104</sup> Section 3.

<sup>105</sup> As discussed in the English environmental context, A. Ogus and C. Abbot, 'Sanctions for pollution: do we have the right regime?' (2002) 13 *Journal of Environmental Law* 283.

<sup>106</sup> Case C-526/08 *Commission v Luxembourg* [2010] ECR I-06151 para. 23.

rounds of litigation affects the probability of being detected and thus also the severity of deterrence on the State.

### 3. Deterring the Firm: Competition Law as a Case-Study

Another public policy of primary prominence in the EU is competition.<sup>107</sup> Protocol No 27 of the Lisbon Treaty recalls that the internal market ‘includes a system ensuring that competition is not distorted’. This system is found in Articles 101 to 109 TFEU, which prohibit several types of distortions of competition by firms and States.<sup>108</sup> Chief in those provisions are the antitrust prohibitions of anticompetitive coordination of Article 101 TFEU and abuse of dominance of Article 102 TFEU. Conceptually, both provisions impose a ‘duty to compete’ on firms.

The political economy reasons that underpin the existence of a EU competition policy are well known.<sup>109</sup> Competition policy is originally a trade instrument. With the elimination of public obstacles to cross-border trade in the internal market, a risk was anticipated in the 1950s that domestic firms subject to foreign competition would attempt to reinstate obstacles to trade through, for instance, private arrangements, market partitioning, distribution contracts, discrimination on grounds of nationality, and boycotts.<sup>110</sup> The original EU Treaty drafters thus sought to cement the process of market integration with a comprehensive set of rules that would tackle both public and private obstacles to trade.

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<sup>107</sup> See *Eco-Swiss* where the ECJ held that the competition rules constituted a ‘matter of public policy’ (Case C-126/97, *Eco Swiss China Time Ltd v Benetton International NV*, ECR [1999] I-03055, para. 39).

<sup>108</sup> The Treaty does not talk of firms, but of ‘undertakings’.

<sup>109</sup> The first Report on Competition Policy stated that ‘Competition is the best stimulant of economic activity since it guarantees the widest possible freedom of action to all’. See Report on Competition Policy 1971, at p. 11. Available at: [http://ec.europa.eu/competition/publications/annual\\_report/ar\\_1971\\_en.pdf](http://ec.europa.eu/competition/publications/annual_report/ar_1971_en.pdf)

<sup>110</sup> See Rapport des chefs de la délégation du Comité gouvernemental institué par la conférence de Messine, also known as SPAAK report, 21 April 1956: ‘La création d’un marché commun exige une action convergente suivant trois grandes orientations, autour desquelles sont articulées les propositions de ce rapport: établissement de conditions normales de concurrence et le développement harmonieux de l’ensemble des économies intéressées permettent d’envisager de parvenir, par étapes successives, à la suppression de toutes les protections qui font actuellement obstacle aux échanges et qui morcellent l’économie européenne’. See also, A. Albors-Llorens, ‘Competition Policy and the Shaping of the Single Market’ in C. Barnard and J. Scott, ‘European Market: Unpacking the Premises (Hart Publishing, 2002) 311–31.

Besides this, the EU competition policy, however, has morphed year after year in a public policy of its own, disconnected from the internal trade agenda of the EU. In this variant, EU competition law prohibits anticompetitive conduct for the sole reason that it inflicts consumer harm, regardless of whether it frustrates the achievement of the internal market.<sup>111</sup> This in turn explains that EU competition cases may also concern business disputes between firms from a single Member State.<sup>112</sup>

Article 103(2) a) TFEU indicates that ‘fines and periodic penalty payments’ are the applicable tools to ensure ‘compliance’ with the EU competition rules. Importantly, the EU Treaties seem to envision competition fines and periodic penalty payments as compliance instruments and is silent on a possible deterrence objective in this context. The implementation of these sanctions is left to be implemented through the adoption of secondary legislation. The key instrument in this regard is Regulation 1/2003.

### **A. Deterrence and Regulation 1/2003**

In line with the above remarks, Regulation 1/2003 (‘Regulation’) enshrines the main principles governing sanctions in competition cases. From the outset, it ought to be mentioned that the Regulation gives the Commission a particularly prominent role in this process.<sup>113</sup> The Commission can impose lump sum fines on undertakings if they ‘intentionally or negligently’ infringe the rules on competition<sup>114</sup> and inflict periodic penalty payments to compel firms to act in a certain way.<sup>115</sup> Fines and periodic penalty payments set by the Commission are immediately

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<sup>111</sup> See D. Gerber, who as early as 1994, predicted this evolution, D. Gerber, ‘The Transformation of European Community Competition Law’ (Winter 1994) 35 *Harvard International Law Journal*, 97.

<sup>112</sup> Or that many interstate cases concern conducts that harms domestic firms, possibly at the advantage of non-domestic firms. Think, for instance, to the situation of collusive or dominant firms from country A that offer better terms to purchaser from country B than to rival from country A.

<sup>113</sup> This was already the case under the preceding regulation, see Regulation 17/62 (EEC Council), First Regulation implementing Articles 85 and 86 of the Treaty, OJ (1962)13, p. 204–211.

<sup>114</sup> Article 23 of Regulation (n 5).

<sup>115</sup> Article 24 *ibid*

applicable. This means that the Commission benefits from the ‘*privilège du préalable*’, and that it can sanction infringements of competition law without seeking prior approval from the Court. To be sure, the ECJ is given an important a role under the Regulation – it has unlimited jurisdiction to cancel, decrease or increase fines imposed by the Commission – but as such, it is secondary.<sup>116</sup> Appeals before the EU courts are, however, not suspensive. This rather strict regime is often rationalized on the ground that fines are said in the Regulation to be not of ‘a criminal law nature’.<sup>117</sup> Once they become final, fines are booked as revenue in the EU budget. They are subsequently discounted from the yearly Member States contributions, as we describe later.<sup>118</sup>

Shortly after the adoption of the Regulation, the Commission brought two important innovations in its fining policy. It introduced a leniency programme exonerating partially or fully from fines those repentant firms that are ready to report unlawful activity.<sup>119</sup> At the same time, the Commission sharpened its fining policy, with the adoption of harsher Guidelines on the setting of fines.<sup>120</sup> As a result, in the past 10 years, the Commission has used the leeway left by the 10 per cent turnover fining cap of the Regulation to hammer firms liable of infringements to Articles 101 and 102 TFEU.<sup>121</sup> This has culminated with a fine of €1,470,515 in the TV and

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<sup>116</sup> Article 31, *ibid*, provides that ‘The Court of Justice shall have unlimited jurisdiction to review decisions whereby the Commission has fixed a fine or periodic penalty payment. It may cancel, reduce or increase the fine or periodic penalty payment imposed’.

<sup>117</sup> Article 23(5), *ibid*.

<sup>118</sup> Section 4.

<sup>119</sup> Commission Notice on Immunity from fines and reduction of fines in cartel cases OJ C 298, 8.12.2006, p. 17–22, and amended in the Communication from the Commission - Amendments to the Commission Notice on Immunity from fines and reduction of fines in cartel cases OJ C 256, 5.8.2015, p. 1–1

<sup>120</sup> Guidelines on the method of setting fines imposed pursuant to Article 23(2)(a) of Regulation No 1/2003 OJ C 210, 1.9.2006, p. 2–5. (‘Guidelines on the method of setting fines’)

<sup>121</sup> In the period between 1990-1994, the Commission imposed €539,691,550 in fines relating to cartel infringements. The figure highly contrasts with the increase in the amount of fines imposed in between 2005-2009: €9,414,012,500 and in between 2010-2014: €8,930,678,674. In the field of abuse of dominance fines have as well seen an increase in the past years. For instance, in 2004, although *Compagnie Maritime Belge* (Case COMP/32.448 and 32.450) received a €3,400,000 fine, Microsoft (COMP/37.792) faced a €497,000,000 fine. In 2008 the Commission imposed a € 899,000,000 penalty payment on Microsoft for non-compliance with the 2004 decision, and in 2009 the manufacturer of chips Intel (Case COMP/37.990) received the highest fine ever in an antitrust case: €1,060,000,000. Lastly, but non-exhaustively, in 2013 (Case COMP/39.530), Microsoft received a €561,000,000 fine for non-compliance. The Commission has nevertheless also imposed symbolic fines in a number of cases, like Case COMP/36.915 - *Deutsche Post AG* (€1,000); Case COMP/36.888 - *Football World Cup* (€1,000); or even avoided to impose them, as in the emblematic case of the ice cabinets, Case COMP/34.073, 34.395 and 35.436 - *Van den Bergh*

computer monitor tubes cartels in 2012. Earlier, in 2009, the firm Intel had to pay a fine of more than €1 billion for unlawful abuse of dominance. These clearly dwarf fines imposed on States as discussed in the previous section.

An issue of major interest concerns the function served by the EU fining system. Both the Treaty, at Article 103 TFEU, as well as Recital 29 of the Regulation, seem to envision fines and periodic penalty payments as intended ‘to ensure compliance’. The Court’s case law, however, has gone beyond the formulaic compliance goal set in the Treaty and secondary legislation, and introduced the additional goal of deterrence. In *Chemiefarma v Commission*, the Court explained that the purpose of sanctions ‘is to suppress illegal activities and to prevent any recurrence’.<sup>122</sup> Even more explicitly, the CJEU noted in *Musique Diffusion Française* that the Commission must ensure that ‘its action has the necessary deterrent effect’.<sup>123</sup> Similarly, in *Archer Daniels Midlands*, the General Court (GC) stressed: ‘[d]eterrence is one of the main considerations which must guide the Commission when setting fines imposed for an infringement of the Community competition rules. If the fine were set at a level which merely negated the profits of the cartel, it would not be a deterrent’.<sup>124</sup> Finally, in *Microsoft v Commission*, the GC talked of the ‘shared characteristics and objectives’ of fines and periodic penalty payments, and noted that ‘a fine and a periodic penalty payment both relate to the conduct of an undertaking as revealed in the past and both of them require a deterrent effect in order to prevent repetition or continuation of the infringement’.<sup>125</sup>

Those judicial pronouncements leave little doubt over the deterrence function of competition fines. This idea has been later embarked by the Commission in various soft law

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*Foods Ltd.* See more in “Cartel Statistics”, available at: <http://ec.europa.eu/competition/cartels/statistics/statistics.pdf>

<sup>122</sup> Case C-41/69, *ACF Chemiefarma v Commission*, [1970] ECR 661, para. 173.

<sup>123</sup> See Joined Cases C-100–103/80 *Musique Diffusion Française v EC Commission (Pioneer)* [1983] ECR 1825 para. 106; Joined Cases C-189/02 P, 202/02 P, 205/02 P – 208 /02 P and C-213/02 P, *Dansk Rorindustri A/S v Commission*, [2005] ECR I-5425.

<sup>124</sup> Case T-59/02, *Archer Daniels Midland v Commission*, [2006] ECR II-3085.

<sup>125</sup> Case T-167/08 *Microsoft Corp. v Commission* [2012] ECR II-000 28 para. 94.

instruments, including the above-mentioned Guidelines, which conspicuously hail deterrence as the primary purpose of the EU fining policy:<sup>126</sup>

The Commission must ensure that its action has the necessary deterrent effect. Accordingly, when the Commission discovers that Article 81 or 82 of the Treaty [today, Articles 102 and 103 TFEU] has been infringed, it may be necessary to impose a fine on those who have acted in breach of the law. Fines should have a sufficiently deterrent effect, not only in order to sanction the undertakings concerned (specific deterrence) but also in order to deter other undertakings from engaging in, or continuing, behaviour that is contrary to Articles 81 and 82 of the EC Treaty (general deterrence).

This notwithstanding, the explicit admission of firm deterrence as the function of competition fines does not imply the exclusion of other goals. Wils for instance observes that competition fines may also have ancillary purposes, like reinforcing the moral commitment to compliance of law-abiding firms.<sup>127</sup> Additional finalities can be ascribed to competition fines. For instance, due to their confiscatory nature, fines are often said to provide revenge to society.<sup>128</sup> They also are deemed to inflict reputational damage with consumers and shareholders, though those secondary effects are not empirically documented.<sup>129</sup>

In competition law, penalties can be inflicted in three types of circumstances: substantive infringement, procedural infringement, and non-compliance with a decision finding of infringement. We deal with these in turn.

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<sup>126</sup> Guidelines on the method of setting fines (n 120), para. 4.

<sup>127</sup> W. Wils, *Efficiency and Justice in European Antitrust Enforcement* (Hart Publishing, 2008) 55.

<sup>128</sup> This idea is originally traced to J. Bentham, *Principles of Penal Law*, (The University of Adelaide Library 2014), at Chapter XVI (Of Vindictive Satisfaction): ‘... every species of satisfaction naturally bringing in its train a punishment to the defendant, a pleasure of vengeance for the party injured. This pleasure is a gain: it recalls the riddle of Samson; it is the sweet which comes out of the strong; it is the honey gathered from the carcase of the lion. Produced without expense, net result of an operation necessary on other accounts, it is an enjoyment to be cultivated as well as any other; for the pleasure of vengeance, considered abstractedly, is, like every other pleasure, only good in itself. It is innocent so long as it is confined within the limits of the laws; it becomes criminal at the moment it breaks them. It is not vengeance, which ought to be regarded as the most malignant and most dangerous passion of the human heart; it is antipathy, it is intolerance: these are the enmities of pride, of prejudice, of religion, and of politics. In a word, that enmity is not dangerous which has foundation, but that which is without a legitimate cause.’ For further references and discussion, see D. G. Owen, ‘Punitive Damages in Products Liability Litigation’ (Jun 1976) 74 *Michigan Law Review* 1257-1371.

<sup>129</sup> See E. M. Iacobucci, ‘On the Interaction between Legal and Reputational Sanctions (2014) 43 *Journal of Legal Studies*, Article 8. What is clear, however, is that competition fines are inapt as such to achieve certain specific purposes, like the compensation of antitrust harm. Even though they give rise to disgorgement, fines are channelled to the EU public budget not to the victims of anticompetitive conduct. Their corrective justice effect is at best limited. Compensation of antitrust harm is a matter left to subjective *inter partes* proceedings before ordinary courts who can apply Articles 101 and 102 TFEU.

## B. Fines for Substantive Infringements

Antitrust fines are primarily inflicted when firms enter into unlawful coordination or abuse of dominance, in breach of the substantive conduct prohibitions set in Articles 101 and 102 TFEU. As per the case law, those fines are seen as instruments to deter anticompetitive business conduct that causes consumer harm.

The spirit of deterrence of antitrust fines transpires from their calculation method, which is explained in the Guidelines.<sup>130</sup> The basic idea consists in capturing the ‘basic amount’ of total profits (or harm) achieved through anticompetitive activity and then inflate it from an ‘additional amount’.<sup>131</sup> With this, the Commission seeks to signal to profit maximizing infringers that an antitrust infringement is a loss-making strategy, because the fine confiscates more than the total anticompetitive profits.

The concrete equation applied by the Commission is, however, a little more complex and can be illustrated with a fictional example. Imagine that firm A is a widget manufacturer who has participated in a price-fixing cartel between 2000 and 2010. In 2010, Firm A sold 1.000.000,00 of widgets at a cartelized unit price of 100€. To calculate the ‘basic amount’ of the fine, the Commission will first compute the value of sales of the goods or services to which the infringement relates. For ease of calculation, the Commission relies on the value of sales achieved in the last full business year of its participation in the infringement. In our example, this represents €100 million. To this amount, the Commission then applies a gravity and duration coefficient.<sup>132</sup> The gravity coefficient seeks to reflect the competitive harm caused by the type of

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<sup>130</sup> See, Guidelines on the method of setting fines (n 120). The Commission’s 2006 initiative to provide transparency on fines calculation is often said to respond to a rights of defence imperative, in what comes close to criminal penalties. However, it seems that the Commission’s primary intention is to raise firms’ awareness of the cost and benefits of an infringement and, in turn, to achieve deterrence. Prior to 2006, the Commission had adopted other Guidelines.

<sup>131</sup> See paras. 19 and 25 of the Guidelines on the method of setting fines (n 120).

<sup>132</sup> In line with the wording of Article 23 (1) of the Regulation (n 5)

infringement under scrutiny. In other words, it is a proxy for the anticompetitive profits achieved thanks to the infringement. As a general rule, for cartels, a proportion of 30 per cent of the value of sales is taken into account.<sup>133</sup> In our example, the Commission will retain an amount of €30 million, which represents a crude estimate of the profits achieved by firm A thanks to the cartel. In turn, the Commission will multiply this amount by the number of years of participation to the infringement. In our example, the Commission will reach a figure of €300 million. This can be deemed to represent the total cartel profits made by firm A, as well as the number of years during which it escaped the surveillance of antitrust agencies (or in economic terms, the probability of being caught). To that figure, the Commission will then apply an ‘additional amount’ of 15 to 25 per cent of the value of sales. This additional amount plays as a deterrence fee. It seeks to tilt the cost-benefit calculus in the negative. In our example, this represents a range of €15 to 25 million. The basic amount that Firm A will thus have to pay is comprised between €315 and 325 million.

The last step of the calculation consists in adjusting that amount in light of possible of aggravating – recidivism, obstruction to investigation and instigation of infringement – and mitigating circumstances – negligence, pro-active cooperation with investigation. Aggravating circumstances like recidivism are sanctioned by a 100 per cent increase of the fine amount. In our example, if Firm A had also participated in a cartel in a distinct market, the Commission can double the fine up to €730-750 million. Finally, if the firm that has infringed competition law has ‘a particularly large turnover beyond the sales of goods or services to which the infringement relates’, the Commission can further increase the fine to achieve additional deterrence.<sup>134</sup>

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<sup>133</sup> Note that this proportion can be decreased if the infringement is less serious.

<sup>134</sup> Guidelines on the method of setting fines (n 120), paras. 30-31.

The magnitude of fines is not without limitations. Twice, the Regulation insists that the fine shall not exceed 10 per cent of its total turnover in the preceding business year.<sup>135</sup> In *Musique Diffusion Française*, the Court explained that the purpose of this cap is ‘to prevent fines from being disproportionate in relation to the size of the undertaking’.<sup>136</sup> This ceiling can, however, be bypassed. Antitrust practitioners are familiar with the Commission’s tactic that consists in bringing mother companies within the calculation of the total turnover, as a means to elevate the 10 per cent cap.<sup>137</sup>

In addition to this, the Commission has put in place several escape or discount routes for antitrust fines in cartel cases. The leniency programme is a case in point. Under this instrument, cartel participants who blow the whistle can expect to obtain fine immunities and reductions, depending on how expediently they report unlawful activity and on the added value brought by their submissions. Moreover, the Commission can enter into settlements with cartel participants who concede to be guilty during the investigation.<sup>138</sup> The settling firms can receive a 10 per cent reduction in return for settling.<sup>139</sup> Lastly, in ‘exceptional circumstances’, the Commission can reduce or squash the fine if the sanctioned firm faces economic hardship.<sup>140</sup> In the period between 2007 and March 2015, such requests became more frequent with the financial crisis but out of 43 requests, only 13 have been accepted, suggesting a low success rate.<sup>141</sup>

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<sup>135</sup> Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty, OJ (2003) L 001, P. 0001 – 0025, Article 23 (2) al. 2-3, Article 23 (4), al. 5.

<sup>136</sup> See Case C-100 to 103/80, *SA Musique Diffusion française contre Commission*, ECR [1983] -01825, para. 119.

<sup>137</sup> See A. Montesa, and A. Givaja, ‘When Parents Pay for their Children’s Wrongs: Attribution of Liability for EC Antitrust Infringements in Parent-Subsidiary Scenarios’ (2006) 29 *World Competition* 555-574.

<sup>138</sup> Commission Regulation (EC) No 773/2004 of 7 April 2003 relating to the conduct of proceedings by the Commission pursuant to Articles 81 and 82 of the EC Treaty, OJ (2004) L 123, at 18, as amended by Commission Regulation (EC) No 622/2008 of 30 June 2008, OJ (2008) L 171, at 3. Commission Notice on the conduct of settlement procedures in view of the adoption of Decisions pursuant to Articles 7 and 23 of Council Regulation (EC) No 1/2003 in cartel cases (Text with EEA relevance), OJ (2008) C 167, at 1–6.

<sup>139</sup> See F. Laina and E. Laurinen, ‘The EU Cartel Settlement Procedure: Current Status and Challenges’ (2013) 4 (4), *Journal of European Competition Law & Practice*, 302-311.

<sup>140</sup> See Guidelines on the method of setting fines (n 120), para. 35: ‘In exceptional cases, the Commission may, upon request, take account of the undertaking’s inability to pay in a specific social and economic context.’ This will be the case if the fine ‘irretrievably jeopardise the economic viability of the undertaking concerned and cause its assets to lose all their value’.

<sup>141</sup> T. Toft (European Commission), *Fines setting by the European Commission for Antitrust Infringements*, 19 March 2015,

To close this presentation, let us mention Article 23(2) of the Regulation. This provision prescribes that fines of a similar magnitude can be applied to firms that contravene a decision, ordering interim measures or to firms that do not comply with the terms of a commitment previously entered by the Commission. This was illustrated in 2013 when Microsoft was found in breach a previous commitment that it would offer users to choose amongst competing Internet browsers in Windows.<sup>142</sup> The Commission fined Microsoft a total of €561 million.

### **C. Fines for Procedural Infringements**

The Commission can also inflict fines for lack of cooperation in the context of antitrust investigations; that is, all investigative measures taken by the Commission, from mere requests for information to interviews, on the spot investigations at firms' premises and documentary seizures.<sup>143</sup> Article 23(1) of the Regulation entitles the Commission to inflict fines on firms that, amongst other things, supply incorrect, incomplete, misleading or belated information. Those fines cannot exceed 1 per cent of the total turnover of the sanctioned firm in the preceding business year. There are no guidelines governing their calculations, though some rare cases offer hints of guidance. In a case well-known from antitrust practitioners, the Commission imposed a €38 million fine on the German energy supplier E.ON, on the ground that employees had tampered with a seal affixed by the Commission during a dawn raid.<sup>144</sup> On appeal, the EU courts confirmed the wide margin of discretion of the Commission in setting such fines. Since then, more fines were imposed in similar cases.<sup>145</sup>

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available online: [http://www.euchinacomp.org/attachments/article/467/EN/2015-03-19\\_TT\\_Fines.pdf](http://www.euchinacomp.org/attachments/article/467/EN/2015-03-19_TT_Fines.pdf)

<sup>142</sup> Commission Decision of 6 March 2013, Case AT.39530 – Microsoft (Tying).

<sup>143</sup> See Articles 17 to 22 of Regulation (n 5).

<sup>144</sup> See Case COMP/39.326 – *E.ON Energie AG*. On the legal basis and consequences for breaching the seal see paras. 104-112. The fine represented 0.14 per cent of its annual turnover (para. 113).

<sup>145</sup> See Commission decision of 24 May 2011 in Case COMP/39.796 – *Suez Environment* breach of seal, €8 million (para. 105).

At their heart, those fines seek to prompt firm compliance with agency requests for information and inspections. Interestingly, however, the CJEU has considered that such fines pursue a deterrence objective too. While it is true that they seek primarily to deter firms from resisting to investigations, the Court seems to believe that they contribute to the sort of substantive deterrence of consumer harm that was discussed previously. In *E.ON v Commission*, the CJEU noted that fines for procedural infringements had to be set high because a firm that breaches a seal can remove incriminating documents from the investigation, and this ultimately risks lowering the fine that may otherwise be inflicted.<sup>146</sup>

#### **D. Periodic Penalty Payments**

The Commission also has the power to inflict periodic penalty payments to compel firms to obey. This can for instance occur when a firm fails to implement a remedial order or to respond to a request for information. Article 24 of the Regulation caps those payments to 5 per cent of the average daily turnover in the preceding business year per day. Like fines for procedural infringements, periodic penalty payments do not seek primarily to deter, but instead to generate compliance.

The *Microsoft* case gives a graphic illustration of periodic penalty payments in antitrust cases.<sup>147</sup> The Commission had ordered Microsoft to share interoperability information with rivals. Microsoft had 120 days to design a licensing framework but for reasons not entirely under its control, Microsoft failed to meet this deadline. The Commission inflicted a €2 million fine on

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<sup>146</sup> See Case C-89/11 P, *E.ON Energie AG v Commission*, ECR [2012] -00000, para. 132: '[...] in the case of an infringement of the substantive rules laid down in Articles 81 and 82 EC, the Commission can impose a fine of up to 10 per cent of the total turnover of the undertaking concerned in the preceding business year. Therefore, an undertaking which hinders the Commission's inspections, by breaking seals affixed by the Commission to preserve the integrity of documents during the period of time necessary for the inspection, could, by removing the evidence gathered by the Commission, escape such a penalty and must therefore be dissuaded, by the amount of the fine set in accordance with Article 23(1) of Regulation 1/2003, from engaging in such behavior'.

<sup>147</sup> See Decision 2007/53/EC, Case COMP/C-3/37.792 — Microsoft, OJ (2007) L 32, p. 23. For previous cases, see also, Commission Decision 14 December 1972, Case IV/26.911 - ZOJA/CSC – ICI, OJ (1972) L 299, p. 51–58.

Microsoft per day of non-compliance. It took approximately two years to Microsoft to comply. The Commission eventually collected €899 million from the software giant.

On appeal, the GC sought, like in *E.ON v Commission*, to bridge periodic penalty payments to fines for substantive infringements.<sup>148</sup> It noted that both fines and periodic payments occur in the same set of circumstances, *i.e.* they are subsequent to (i) a finding of substantive infringement; (ii) a cease and desist order; and (iii) a behavioural remedy. The GC statement, however, is dubious. Competition fines can be inflicted as soon as an infringement is found, absent a cease a desist order (for instance, if conduct has ceased in the past) and/or a behavioural remedy. This does not seem to be the case of a periodic penalty payment, which can only be issued if the decision enshrines a ‘do/not do’ order.

A similarly disputable logic can be found in the GC statement to the effect that ‘fine and a periodic penalty payment both relate to the conduct of an undertaking as revealed in the past and both of them require a deterrent effect in order to prevent repetition or continuation of the infringement’.<sup>149</sup> The idea that periodic penalty payments seek to prevent repetition or continuation of the infringement, again, cannot be true. If this was the case, periodic penalty payments should be pronounced in all antitrust infringement cases, which they do not seem to be. What those two remarks show is a commitment to expand the language of deterrence everywhere in competition law, even when the case for this is not entirely compelling.

## **E. Summation**

The outline above shows at least two important findings. First, the *deterrence* objective permeates all the types of fines that can be inflicted by the Commission. The fact that the deterrence

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<sup>148</sup> GC, *Microsoft Corp. v Commission*, T-167/08, ECR [2012] 00000.

<sup>149</sup> *Id.* para. 94.

objective has been imported to procedural fines and periodic penalty payments, though those instruments do not seem initially designed to achieve deterrence, is evidence thereof.

Second, the Court seems to use deterrence as an objective to justify the escalation of fines and the large discretion of the Commission in antitrust cases. Perhaps the best proof of this lies in the fact that Commission has developed a variety of deterrence-spirited doctrines, which have been litigated before the EU courts and the EU judicature has consistently backed the Commission's interpretations.<sup>150</sup> Those judicially-endorsed deterrence doctrines include: (i) the reliance of the Commission on the presence of mother companies as a means to inflate the maximum amount of the fine (under the so-called 'parental liability' doctrine);<sup>151</sup> the Commission's policy of affirming liability for fines vis-à-vis firms that acquire previous infringers of competition law;<sup>152</sup> the hotly debated theory of infringement by complicity, which fines firms such as consulting and audit companies who assist others in a competition infringement, even though they are not active in the market;<sup>153</sup> the policy of including captive sales within vertically integrated firms in the calculation of fines;<sup>154</sup> and the absence of consideration of internal company-compliance programmes as a mitigating circumstance in fines set for competition infringements.<sup>155</sup>

All those doctrines *de facto* lead to increased fines or to the dismissal of mitigation causes.<sup>156</sup> And their common thread is that they are reasoned in deterrence terms. For instance, in the

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<sup>150</sup> See, I. Forrester, 'A challenge for Europe's Judges: the review of fines in competition cases' (2011) 36 *European Law Review* 202.

<sup>151</sup> Case C-97/08 P *Akzo Nobel and Others v Commission* [2009] ECR I-8237, para. 58. See also, T-85/06, *General Química and Others v Commission* [2008] ECR II-00338 and Case C-521/09 P, *Elf Aquitaine SA v Commission*, nyr.

<sup>152</sup> Case IV/31.865 - *PVC* [1994], OJ (1994) L 239, para. 41 'Where the infringing undertaking itself is absorbed by another producer, its responsibility may follow it and attach to the new or merged entity.'

<sup>153</sup> Case C-194/14 P, *AC-Treuband AG v Commission*, (nyr.)

<sup>154</sup> A Winckler, F.C. Laprévotte, 'Selected Issues raised by recent cartel decisions', *Competition Policy International*, 2013, available at: <https://www.competitionpolicyinternational.com/assets/Uploads/EUNovember.pdf>

<sup>155</sup> D. Geradin, 'Antitrust Compliance Programmes & Optimal Antitrust Enforcement: A Reply to Wouter Wils' (2013) 1 *Journal of Antitrust Enforcement* 325.

<sup>156</sup> With the possible rejuvenation of the inability to pay doctrine amidst the economic crisis of the late 2000s, but this is more of contextual evolution.

complicity case *AC Treuband*, the CJEU justified the imposition of a fine on the accomplice nothing that the contrary interpretation:<sup>157</sup>

would be liable to negate the full effectiveness of the prohibition laid down by that provision, in so far as such an interpretation would mean that it would not be possible to put a stop to the active contribution of an undertaking to a restriction of competition simply because that contribution does not relate to an economic activity forming part of the relevant market on which that restriction comes about or is intended to come about.

In this context, antitrust practitioners often claim that judicial review discharged by the EU courts is deficient, relying on the European Convention of Human Rights (ECHR) in voicing their concern. Indeed, in a 2012 *Menarini* ruling, the European Court of Human Rights (ECtHR) held that Article 6 of the Convention requires that decisions from administrative agencies that inflict fines are amenable to challenge before a court with full jurisdiction. The ECtHR defined full jurisdiction as the ability to re-craft entirely the administrative decision, in light of all facts and legal arguments.<sup>158</sup> The Court reasoned that administrative fines are of a criminal nature when they aim at punishing an infringement and at deterring future fines, and provided a certain level is met.<sup>159</sup> In *KME v. Commission*, however, the ECJ closed the debate. Leaving open the question whether antitrust fines are criminal, it considered that the EU system was at any rate Article 6(1) compliant.<sup>160</sup> The Court made short shrift of the argument noting that:

The review provided for by the Treaties thus involves review by the Courts of the European Union of both the law and the facts, and means that they have the power to assess the evidence, to annul the contested decision and to alter the amount of a fine. The review of legality provided for under Article 263 TFEU, supplemented by the unlimited jurisdiction

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<sup>157</sup> *AC-Treuband AG v Commission* (n 153).

<sup>158</sup> ECtHR, *A. Menarini Diagnostics S.R.L. c. Italie*, Requête no 43509/08), 27 September 2011, para. 57. See M. Bronckers and A. Vallery, 'Business as usual after Menarini?' (2012) 3(1) *Mlex Magazine* 44-47, D Waelbroeck, 'L'Impact de la CEDH sur les Procédures en Droit de la Concurrence' (presentation at the Université Libre de Bruxelles on 24 April 2012).

<sup>159</sup> ECtHR, *Menarini*, *ibid*, para. 42.

<sup>160</sup> The Court states at para. 133 that: 'The review provided for by the Treaties thus involves review by the Courts of the European Union of both the law and the facts, and means that they have the power to assess the evidence, to annul the contested decision and to alter the amount of a fine. The review of legality provided for under Article 263 TFEU, supplemented by the unlimited jurisdiction in respect of the amount of the fine, provided for under Article 31 of Regulation No 1/2003, is not therefore contrary to the requirements of the principle of effective judicial protection in Article 47 of the Charter',.

in respect of the amount of the fine, provided for under Article 31 of Regulation No 1/2003, is not therefore contrary to the requirements of the principle of effective judicial protection in Article 47 of the Charter.

This sort of reasoning is an ‘intellectual somersault’.<sup>161</sup> It is akin to saying that there cannot be inefficient judicial review in practice because the text of the Treaty says the contrary. This, clearly, cannot be in line with the requirements of the rule of law. In *Telefonica*, AG Wathelet exhorted the ECJ to set a higher standard of judicial review in relation to fines.<sup>162</sup> The Court, however, left the proposition unacknowledged.

#### 4. Two-Tier Deterrence Hypothesis

A possible method to understand how the EU deters the State, on the one hand, and firms on the other, is to approach our above findings from three distinct angles (see Table 1): purpose of fines imposed (*functional angle*); method followed to set and liquidate the penalty (*operational angle*); and procedure for the imposition of fines (*procedural angle*).

##### A. Functional Angle

It is by now apparent that the penalties inflicted to States in EU environmental law and to firms in EU competition law pursue distinct aims. With the exception of lump sums payments, environmental penalties essentially seek to prompt the State to comply and put an end to an on-going infringement, while competition penalties mainly purport to deter firms from future infringements. This has led to two distinct systems of deterrence – soft and hard – being applied to the State versus the firm, which can be observed at several levels.

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<sup>161</sup> Antitrust and Privilege, An EU court restricts attorney-client confidentiality, Sept. 16, 2010, available at: <http://www.wsj.com/articles/SB10001424052748703376504575491603119775806>

<sup>162</sup> Opinion AG Wathelet, 26 September 2013, *Telefónica SA and Telefónica de España SAU v European Commission*, Case C-295/12 P., paras. 125-129.

First, in environmental law, periodic penalties and fines for non-communication are not inflicted when the State terminates the infringement during the proceedings. This, on the other hand, is immaterial in competition cases, and firms are sanctioned even if they have terminated the infringement during the proceedings.

Second, whilst the periodic penalty payments inflicted in competition cases are primarily designed to force a firm to comply with a Commission decision, the case law seem to see them as a deterrence device, as can be seen from the *Microsoft* judgment. This interpretation is similar to the one found in the Commission's guidelines on sanctions under Article 260(2) TFEU. However, where things diverge is in relation to the practical admissibility of cooperation related defences. In environmental law cases, the case law tends to accommodate arguments to the effect that the infringing State has exhibited a degree of *bone fide* cooperation. In contrast, in competition law, those arguments were given short shrift. Perhaps the sole analogy is inability to pay and the economic state of the Member State, though it is clear in competition law that inability to pay applications are rarely successful.

Third, even in those areas where deterrence infiltrates environmental law, the concept applied is one of specific deterrence. The idea is to deter the State that breaches EU law from present and future infringements, and only this State. This can be seen in *Commission v Italy*, where recidivism was taken into account.<sup>163</sup> In contrast, the policy that permeates competition law is both of specific *and* general deterrence. The idea is certainly to deter the firm under investigation but also to deter *all* other firms in the economy. This is clear from both the case law and the Guidelines on the method of setting fines.

Fourth, a discussion has taken place in competition law in relation to the compliance programmes internally designed by firms to reduce risks of antitrust infringements.<sup>164</sup> Firms have

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<sup>163</sup> Or the re-occurrence of infringements, see *Commission v Italy* (n 27) para. 86.

<sup>164</sup> W., Wils, 'Antitrust Compliance Programmes & Optimal Antitrust Enforcement' (2013) 1 *Journal of Antitrust Enforcement* 52, Geradin, 'A Reply to Wouter Wils' (n 155).

sought to advocate that the setting up of compliance programmes should lead to fines reductions in the form of mitigating circumstances. Thus far, the CJEU has refused to consider fines reductions to firms with a compliance programme.<sup>165</sup>

The Commission has similarly been reluctant to take compliance efforts into regard in calculating fines imposed on firms. In a decision of 2013, the Commission noticed that Microsoft had not complied with a previous decision ordering the setting up of a choice screen of Internet browsers on Windows for PC. The Commission proceeded to inflict fines for non-compliance. Microsoft advanced that it had taken various steps to address compliance problems, and prevent their repetition in the future. It had, in particular, created a new function of Antitrust Compliance Officer.<sup>166</sup> The Commission noted that while they were ‘important’, it was under ‘no duty ... to reduce the fine’ and that it was at any rate ‘impossible to determine the effectiveness of the internal measures taken by Microsoft to prevent future non-compliance’.<sup>167</sup>

To some extent, and in some cases, the compliance efforts undertaken by firms have even been interpreted as aggravating factors in past case law.<sup>168</sup> Even though the Commission has expressed in its compliance brochure that this would no longer be the case,<sup>169</sup> the Microsoft decision indirectly hints at this outcome. In this decision, the Commission suggested that Microsoft’s ‘significant competition law expertise’ had the effect of lowering the threshold for negligence or of raising the threshold for excusability.<sup>170</sup>

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<sup>165</sup> The Court held in *Hercules*: ‘whilst it is indeed important that the applicant took steps to prevent fresh infringements [...], that circumstance does not alter the fact that an infringement has been found to have been committed in the present case.’ (T-7/89 *SA Hercules Chemicals NV v. Commission*, RC [1991] II-01711, paras. 354-357.). See, similarly, Compliance matters – brochure by the EU Commission, edition 2012, 20-21, available at: <http://bookshop.europa.eu/en/compliance-matters-pbKD3211985/>: ‘the mere existence of a compliance programme will not be considered as an attenuating circumstance. Nor will the setting-up of a compliance programme be considered as a valid argument justifying a reduction of the fine in the wake of investigation of an infringement.’

<sup>166</sup> Decision, Case COMP/39.530, *Microsoft - Tying*, para. 36.

<sup>167</sup> Ibid. para. 73.

<sup>168</sup> See Commission Decision 14 October 1998, IV/F-3/33.708 (*British Sugar II*).

<sup>169</sup> See Compliance matters – brochure by the EU Commission, edition 2012, p.21: ‘It goes without saying that the existence of a compliance programme will not be considered an aggravating circumstance.’

<sup>170</sup> Decision, COMP, AT.39.530, *Microsoft-Tying*, paras. 49 and 69.

This further shows that cooperation does not constitute a key driver of the fining policy in competition law, in much contrast with environmental law, where concrete, cooperative steps that the Member States may have are favourably included in the Court's calculation. Environmental policy seems thus to gravitate around a soft deterrence paradigm, driven by the ambition to promote cooperation between the Commission and the State specifically infringing the duty to transpose. The logic of competition law seems in contrast to be one of hard deterrence that seeks to ensure prevention of anticompetitive harm through the sending of general signals to the entire economy. This gives currency to the idea that deterrence is soft against the State and hard against the firm.

## **B. Operational Angle**

Given the limited experience of fines against States under Article 260 TFEU, it is impossible to benchmark them with the level of fines inflicted on firms in competition law. Instead, a better approach is to discuss the general principles that underpin the quantum of the fines imposed in both disciplines. In this respect, a marked difference between environmental and competition penalties lies in the methodology followed to set fines. Whilst an objective and transparent algebraic equation governs the calculation of fines in competition proceedings, a much more abstract and discretionary methodology seems to apply to environmental fines.

The reason that explains the discrepancy between the scientific approach applied in competition proceedings and the impressionistic one followed in environmental law may hinge on the former's greater permeability to deterrence theory, which teaches that fines must be set on explicit criteria, so that profit maximizing criminals understand that the costs of infringement exceed by some tractable margin their benefits. We explore this possibility later. What the case law above, nevertheless, shows is that environmental jurisprudence is erratic not necessarily

because the Court enjoys broad discretion in calculating the fines but because it fails to rationalize its methodology in fixing them.<sup>171</sup> Ultimately, this raises serious issues regarding the appropriate level of deterrence, as well as warnings of fading legal certainty.<sup>172</sup>

A second, unnoticed difference is that the liquidation of fines in environmental and in competition law cases, though it is subject to the same principles, has drastically distinct consequences. To understand this, a detour through Article 311 TFEU is necessary. This article governs the 'Union's own resources', which are primarily financed by yearly fixed instalments paid by the Member States.<sup>173</sup> Given that the fines inflicted by the EU institutions come on top of this, as a rule, the Treaty mandates that this surplus should be discounted from the Member States yearly instalments.<sup>174</sup> This applies to fines issued under competition law, as well as to penalties inflicted to the Member States under Article 260 TFEU. The implication thereof is remarkable: when Member States breach their duty to transpose, they make payments that subsequently revolve back to them through the Article 311 TFEU mechanism. When firms breach their duty to compete, on the other hand, they do not enjoy such a monetary return. Even if we were to assume equal severity in payments between State and firm, the level of deterrence achieved vis-à-vis both of them would be significantly higher for the firm.

### C. Procedural Angle

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<sup>171</sup> A. Kornezov, 'Imposing the Right Amount of Sanctions under Article 260(2) TFEU: Fairness v Predictability, or How to "Bridge the Gaps"' (2014) 20 *Colombia Journal of European Law* 283, 284.

<sup>172</sup> Lees makes a similar point but in relation to legal certainty for operators covered by a set of environmental directives, see E. Lees, *Interpreting Environmental Offences: The Need for Certainty* (Hart Publishing/Bloomsbury 2015).

<sup>173</sup> 2014/335/EU, Euratom: Council Decision of 26 May 2014 on the system of own resources of the European Union OJ (2014) L 168, p. 105–111.

<sup>174</sup> See Article 83 of the Regulation (EU, Euratom) No 966/2012 of the European Parliament and of the Council of 25 October 2012 on the financial rules applicable to the general budget of the Union and repealing Council Regulation (EC, Euratom) No 1605/2002 OJ (2012) L 298, p. 1–96. According to the Financial Reports of the Commission, in 2012, €3.5 billion was recorded as income from fines, representing about 2.6 per cent of the EU budget in 2012. In 2013, this figured raised to a total amount of €2.9 billion, which represented about 2.2 per cent of the EU budget for that year. The trend continues, and in 2014 fines worth a total of €4.5 billion represented around 3.2 per cent of the EU budget in 2014.

The procedural setting to which States and firms are subject in environmental and competition proceedings are radically different. In environmental law, fines can only be set following judicial proceedings before the CJEU. This can be called an *adjudication* model. Moreover, with the exception of fines for non-communication, two rounds of proceedings before the CJEU – first, under Article 258 TFEU and then under Article 260 TFEU – are necessary before a fine is inflicted against a State. In contrast, in EU competition law, fines can be set by the Commission in the first place. Court’s proceedings are not needed. That can be called a *self-executing* model. What is more, the introduction of review proceedings before the CJEU has no suspensive effect on the fines set by the Commission (unless the applicant requests interim measures). Importantly, this is even true in respect of periodic penalty payments, which is the fining instrument that comes closest to those found in environmental law. The Commission can set periodic penalty payments without requesting prior CJEU approval.

This dual procedural setting is also a factor that influences the degree of deterrence achieved by the two policies. The threat of punishment is more credible when the enforcement structure follows a self-executing model than when it follows an adjudication model. This threat is even exacerbated by the fact that when fines or periodic penalty payments are appealed on the basis of Article 261 TFEU, the Court has unlimited jurisdiction to cancel them, but also decrease or increase them.

<b>Deterrence</b>	<b>State</b>	<b>Firm</b>
<b>Functionality Angle</b>	Ending a specific breach	Deterring from anticompetitive behaviour specifically and generally
<b>Operational Angle</b>	Wide ECJ discretion	Wide Commission discretion
<b>Procedural Angle</b>	Pre-approval by the ECJ either in two or one round of legal proceedings (adjudication model)	Commission’s fining with immediate applicability and limited judicial review (self-executing model)

**Table 1**

## 5. Deterrence Theory

The two-tier soft versus hard deterrence regime found in EU law can be looked at through the lenses of deterrence theory. Gary Becker, a Nobel Prize economist, provided in a 1968 paper a commonly used theoretical framework for deterrence. At its heart, Becker's work tried to answer the following normative question: 'how many resources and how much punishment should be used to enforce different kinds of legislation'.<sup>175</sup> Becker posits that crime is an 'economic activity', and that a rational economic agent commits an offense if the expected utility to him exceeds the utility he could get by using his time and other resources at other activities. In contrast, Becker predicts compliance if the benefit acquired from law-abidance exceeds penalties for non-compliance.<sup>176</sup> This calculation in turn is a function of the probability of conviction ( $p$ ), and of the size of the punishment if convicted ( $f$ ), and Becker shows that criminals are often more sensitive to a change in ( $p$ ) than ( $f$ ).<sup>177</sup> Two points based on a closer literature review on this topic are necessary to set out in this article.

First, in spite of its links with the traditional utilitarian concept of punishment, developed by early classical philosophers like Beccaria, Bentham and More<sup>178</sup> and of the considerable body of research devoted to deterrence theory by modern economists,<sup>179</sup> deterrence remains unpopular

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<sup>175</sup> G. Becker, 'Crime and Punishment: An Economic Approach' (n 10). This is not to overlook earlier 'economically oriented' writings on public enforcement by Montesquieu, Beccaria and Bentham. For a brief overview thereof see e.g. M. Polinsky and S. Shavell, 'The Theory of Public Enforcement of Law' in Mitchell Polinsky and Steven Shavell (eds), *Handbook of Law and Economics*, vol 1 (Elsevier 2007) 403, 405.

<sup>176</sup> C. Rechtschaffen, 'Deterrence vs. cooperation and the evolving theory of environmental enforcement' (1998) 71 *Southern California Law Review* 1181, 1186.

<sup>177</sup> See e.g. M. Polinsky and S. Shavell, 'The Economic Theory of Public Enforcement of Law' (2000) 38 *Journal of Economic Literature* 45.

<sup>178</sup> See Stigler's Theory of Optimal Law Enforcement in Thomas More's Utopia, suggested by G. Weyl in (2011) 119 *Journal of Political Economy*, citing Thomas More in reference to Stigler's work: 'I think putting thieves to death is not lawful; and it is plain and obvious that it is absurd, and of ill-consequence to the commonwealth, that a thief and a murderer should be equally punished; for if a robber sees that his danger is the same, if he is convicted of theft as if he were guilty of murder, this will naturally incite him to kill the person whom otherwise he would only have robbed, since if the punishment is the same, there is more security, and less danger of discovery, when he that can best make it is put out of the way; so that terrifying thieves too much, provokes them to cruelty. [Sir Thomas More, Utopia, bk. I]'

<sup>179</sup> See G Stigler, *The Optimum Enforcement of Law*, in *Essays in the Economics of Crime and Punishment*, G. S. Becker and W. M. Landes, eds., NBER, 1974.

with lawyers and policymakers.<sup>180</sup> The reasons for this are manifold. One is that deterrence is not all that matters, and that additional non-consequentialist considerations like fairness, compensation and vengeance might come into play when enforcing the law.<sup>181</sup> Another is that deterrence is deeply conditioned on rational choice assumptions, and that this fails to take into account the bounded rationality hypothesis, and in particular that non-compliance may be the result of, for instance, rational ignorance.<sup>182</sup> Moreover, there is no consensus within the economic literature on how deterrence ought to be calculated or according to which methods.<sup>183</sup>

Some of those causes, much less all of them, may provide explanation for the relatively soft penetration of deterrence philosophy in EU environmental law. For instance, lack of resources and expertise was found to be an explanatory factor for poor implementation of EU environmental law in the Member States.<sup>184</sup> Moreover, much of the current regulatory debates in environmental law look beyond ‘orthodox deterrence theory’<sup>185</sup> in discussing enforcement mechanisms. The prevailing cooperative-oriented approach instead attempts to create enforcement structures that appeal to interests beyond that of mere profit-maximization in securing compliance.<sup>186</sup> This is not to say that deterrence is irrelevant in the literature – it is

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<sup>180</sup> Veljanovski, *Economic Principles of Law* (n 11) 12.

<sup>181</sup> See L. Kaplow and S. Shavell, ‘Fairness versus Welfare: Notes on the Pareto Principle, Preferences, and Distributive Justice’, *Journal of Legal Studies* 32 (January 2003).

<sup>182</sup> J. Braithwaite, *Crime, Shame and Reintegration* (Cambridge University Press 1989).

<sup>183</sup> On the question of optimal deterrence, see A. Mitchell Polinsky and S. Shavell, ‘Punitive Damages: An Economic Analysis’ (1999) 111 *Harvard Law Review* 869. Cf. C. Sunstein, D. Schkade and D. Kahneman, ‘Do People Want Optimal Deterrence?’ (1999) John Olin Program in Law and Economics Working Paper No. 77. On a discussion on whether deterrence or e.g. compensation ought to be regulatory goals, see D. Epple and M. Visscher, ‘Environmental Pollution: modeling occurrence, detection and deterrence’ (1984) 27 *Journal of Law and Economics* 29, 56-57. On a debate on what type of sanctions to enforce, see Ogus, who finds regulatory scenarios where hassle and inconvenience works better than financial sanctions to achieve compliance, see A. Ogus, ‘Regulatory Sanctions, Wheel-Clamping and Hassle’ in Erik Rosaeg, Hans-Bernd Schäfer and Endre Stavang (eds), *Law and Economics* (Cappelen Akademisk 2010) 127. Moreover, there is no consensus on whether deterrence ‘works’. Peers raises this point with regard to Article 260(2) TFEU and how the Commission has yet to complete a review on its effectiveness as a general deterrent (here meaning, ending the particular breaches of EU law sanctioned by the Court), see S. Peers, ‘Sanctions for Infringement of EU Law after the Treaty of Lisbon’ (2012) 18 *European Public Law* 33, 57.

<sup>184</sup> IMPEL, Final Report 23 March 2015, available at <http://impel.eu/wp-content/uploads/2015/03/Implementation-Challenge-Report-23-March-2015.pdf>. Note that also low level of fines was part of the explanation for non-compliance.

<sup>185</sup> A. Ogus and C. Abbot, ‘Sanctions for pollution’ (n 105) 283.

<sup>186</sup> See n. 3.

simply not considered to be the whole and sole solution to enforcement.<sup>187</sup> What is crucial to note here is that national enforcement reports, as well as surveys of legislative designs for effective enforcement, all point to low fines as the root cause of under-deterrence and non-compliance.<sup>188</sup> The need for dissuasive penalties for environmentally harmful activities was also made clear by introducing Directive 2008/99/EC on the protection of the environment through criminal law.<sup>189</sup> Most of those findings, nevertheless, concern deterrence measures available to the Member State vis-à-vis firms – not deterrence against the State.

In contrast, the objections levelled at deterrence theory have seemingly had less impact on competition law, owing possibly to the widespread acceptance, both at theoretical and methodological levels, of the rational choice hypothesis in this field of the law. In this regard, the firm, which is the main addressee of the competition rules, is widely seen, in the case law, as a profit maximizing entity, that decides on whether to breach the duty to compete on grounds of cost-benefit analysis. To be sure, some discussions remain. For instance, some propose to set optimal fines at the level of victims' loss so as to avoid the deterrence of efficient infringements when the perpetrators gain are superior.<sup>190</sup> At the epistemological level, the penetration of optimal enforcement literature in antitrust is also not surprising considering that a number of scholars who pioneered works on deterrence were also active antitrust academics.<sup>191</sup>

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<sup>187</sup> For example, deterrence is part of Ayres and Braithwaite's enforcement pyramid, *ibid.*

<sup>188</sup> See e.g. R. Macrory, *Regulatory Justice: Sanctioning in a post-Hampton World* (Cabinet Office, May 2006) (Macrory Report), and reflected upon in R. Macrory, 'New approaches to regulatory sanctions' (2008) 20 *ELM* 210. Support for sanctions is similar found in E. Scotford and J. Robinson, 'Legislative design for effective enforcement of environmental law – a UK perspective' (conference paper delivered on the 3<sup>rd</sup> European Environmental Law Forum Conference, on file with the authors). See also IMPEL, Final Report 23 March 2015 (n 184).

<sup>189</sup> Directive 2008/99/EC of the European Parliament and of the Council of 19 November 2008 on the protection of the environment through criminal law, OJ 2008 L328/28.

<sup>190</sup> R. Posner, *Antitrust Law* (2<sup>nd</sup> ed. University of Chicago Press 2001) Chapter 10.

<sup>191</sup> G.J. Stigler, 'The Optimum Enforcement of Laws.' (May/June, 1970) 78 *Journal of Political Economy* 526-36; R. A. Posner, 'An Economic Theory of the Criminal Law,' (1985) 85 *Columbia Law Review* 1193, L. Kaplow 'Optimal Deterrence, Uninformed Individuals, and Acquiring Information About Whether Acts Are Subject to Sanctions' (1990) 6(1) *Journal of Law, Economics, & Organization* 93-128.

Another possible explanatory factor for the fact that deterrence vis-à-vis the State is neglected<sup>192</sup> has to do with the fact that legal scholarship may be more concerned with deliberating substantive law options, as opposed to law enforcement issues,<sup>193</sup> all the more so in areas like environmental law where the substantive rules are often taught of as less mature in age and constitutional in status than well-established legal disciplines, such as competition law.<sup>194</sup> Our view is that the explanation lies elsewhere.

In essence, it is that the State is widely perceived to be a social organisation that is unresponsive to economic incentives and that it therefore falls through the cracks of rational choice doctrines to which deterrence theory belongs. We argue, however, that this viewpoint deserves discussion. As previously noted, the State can be, as Coase once pointed out, characterised as a super firm, and accordingly, it should be responsive, to a certain extent, to similar incentives and constraints.<sup>195</sup>

On closer analysis, the idea that deterrence theory does not apply to the State, or not entirely, seems to rest on one main assumption: that States enjoy a taxation and regulation monopoly so that their resources are infinitely more abundant than those of firms. As is well known, a State can indeed ultimately resort to taxation and regulation to increase its appropriation of society's resources.<sup>196</sup> This system, as Acemoglu and Robinson explain, is based on the Weberian view that States shall be given this monopoly of violence in order to avert, what

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<sup>192</sup> With some exceptions: C. Rechtschaffen and D. Markell, *Reinventing Environmental Enforcement & the State/Federal Relationship* (Environmental Law Institute 2003), where, however, the focus is on issues concerning competence as opposed to *per se* deterring the State.

<sup>193</sup> N. Gunningham, 'Enforcing Environmental Regulation' (n 3) 171.

<sup>194</sup> E. Fisher and others, 'Maturity and Methodology: Starting a Debate about Environmental Law Scholarship' (2009) 21 *Journal of Environmental Law* 213. Note, however, that Fisher and others do not compare environmental law and competition law in this regard but environmental law with traditional legal disciplines more generally.

<sup>195</sup> For another analogy, see S. Kan and C.S. Hwang, 'A Form of Government Organization from the Perspective of Transaction Cost Economics' (1996) 7 *Constitutional Political Economy*, 197-219, who look at 'what would be the implications for a democratic government if it were based on the principles of separation of decision control and decision management' that apply in a firm.

<sup>196</sup> G. Brennan and J. M. Buchanan, *The Power to Tax: Analytical Foundations of a Fiscal Constitution* (Indianapolis, 2000), available at; <http://www.econlib.org/library/Buchanan/buchCv9c4.html>;

Thomas Hobbes described, ‘a war of all against all’, also known as the state of nature.<sup>197</sup> As a result of this Weberian monopoly, the ‘elasticity of response’ of a State to a change in punishment, be it in terms of (p) or (f), is necessarily more limited than the elasticity of a firm. Put more prosaically, a similar change in penalties should yield less deterrence effects vis-à-vis the State than vis-à-vis the firm. This problem is further compounded by the fact that, as mentioned at the outset of this article, unlike a firm, the State is a social organization that is not subject to the process of competition, which fosters incentives for spontaneous compliance. Whilst a fined firm may be sanctioned by its shareholders and customers, who will relocate their resources from it towards rivals, the State is a centralized entity that cannot be as easily avoided by taxpayers.

There is, however, a limitation to the ability of States to evade the deterrent effect of financial penalties. A State power to tax and regulate is limited by accountability before the public opinion. In turn, if State governance works well, financial penalties should deter, at least to some extent, States’ infringements of the law.

This ideal world, however, fail to take account of one major agency problem that is said to inherently limit deterrence vis-à-vis the State.<sup>198</sup> The literature advances that the penalty inflicted to the State, and the incentives it conveys, might never be delegated down to the individual official responsible of the infringement of the law, thereby failing to induce agents to internalise the costs of their illegal behaviour.<sup>199</sup> This argument, however, fails for a number of reasons.

First, the question of whether incentives are transferred from the organisation to its agent is not peculiar to the State but exists in many vertical organisations also subject to agency problems like firms. In fact, if one were to follow this claim, then the idea of deterring firm should be abandoned altogether. Moreover, States are less prone to timing distortions than firms.

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<sup>197</sup> D. Acemoglu and J. Robinson, *Why Nations Fail: The Origins of Power, Prosperity and Poverty* (New York: Crown Publishers, 2012). We mean here a Weberian monopoly of legitimate violence over a territory and the ability of the State to regulate economic activity, impose taxes and provide public goods.

<sup>198</sup> See Dari-Mattiacci, Garoupa and Gomez-Pomar, ‘State Liability’ (n 12) 776.

<sup>199</sup> Ibid.

As is well known, workers' mobility is less important in the public than in the private sector due to rigid dismissal rules. Accordingly, while in a firm, it may be impossible to channel down the penalty to the responsible individual if he or she has left the organisation, this risk is less acute in a public administration. Last, whilst it is true that public administrations have rigid labour rules, and may be less likely to adjust individual officials' benefits in response to a breach of the duty to transpose, it is equally true that many OECD countries are reported to introduce performance approaches in all areas of public administration.<sup>200</sup> This evolution is likely to make it increasingly possible to channel down liability towards the responsible individual and, beyond this, deter unlawful behaviour at decentralised levels. With all this, the mainstream view whereby a State would, unlike a firm, be predominantly insensitive to penalties deserves to be re-qualified.

Additionally, this view does not imply by necessity that a soft deterrence policy shall prevail. The State inelasticity to penalties may not be linear (i.e. equal at all levels) and at higher fines levels, Governments might be more elastic to penalties. If the frequencies and magnitude of fining were intensified and moved to shocking levels for the public opinion, more accountability from the Government could arguably be expected. Beyond action on the magnitude of penalties, it is also well known that the public opinion is sensitive to statistics and numbers, so that a more objective, quantified and transparent penalties policy against the State may also improve State deterrence.<sup>201</sup> Last, a number of exogenous factors, like the economic context, may make States more sensitive to penalties than generally assumed. In particular, State elasticity to penalties may be particularly important in contexts of fiscal austerity and limited budgetary manoeuvre to raise taxes. In sum, the idea that a State cannot be deterred through financial penalties is probably

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<sup>200</sup>See The Organisation for Economic Co-operation and Development, *Modernising Government: The Way Forward* (OECD Publishing, 2005) available at: <http://dx.doi.org/10.1787/9789264010505-en>: 'A number of underlying trends influence governments to review and reorganise the way they work. These include: Incentives: There is a new tendency to apply to government organisations the thinking derived from economics on the way incentives of different kinds influence people's behaviour. This has meant that attempts to change the public service culture increasingly include organisational change.'

<sup>201</sup> To some extent, States failure to transpose legislation is not different to standard cases of waste of taxpayers money (equivalent to document examples of failed megaprojects, etc.).

overstated, and there is a plausible claim to make that a harder, or at least more explicit and structured, deterrence policy can yield some effects on States.

## 6. Conclusion

In this article we have examined the relevant environmental and competition legal frameworks to show the existence of a two-tier deterrence regime, depending on whether the State or the firm is the addressee of the legal duty under EU law. A salient trait of this divide is that deterrence imposed on the State is soft and patterned according to the adjudication model where the Court is predominant, whereas deterrence imposed on the firm, on the other hand, is hard and relies on a self-executing model that lends the Commission broader discretion in determining and enforcing sanctions.

We acknowledge that a wealth of explanatory forces underlie the two-tier deterrence hypothesis, many, which are left unexplored in this study. One such reason is certainly the EU's institutional design. Because legislative power in the EU context is exercised by the Member States through their representatives in the Council,<sup>202</sup> it is assumed that the State will abide by the law they have collectively produced so that deterrence seems less relevant.<sup>203</sup> Another reason may be that key public policies – here, environmental protection and competition – are valued differently, which takes expression not only in soft and hard deterrence but also in the extent to which the Commission is entrusted with discretion, as well as manpower to enforce these.<sup>204</sup>

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<sup>202</sup> Article 16(1) TEU.

<sup>203</sup> Tesouro, for instance, condemned the introduction of sanctions under Article 260 TFEU with the argument that remedies against the conduct of an administration can result in the annulment of an act or an order for reparation to be made for the damage caused – never a pecuniary sanction. See G. Tesouro, *La Sanction des Infractions au Droit Communautaire* (Report presented to the 15<sup>th</sup> FIDE Conference 1992) 481-482, as cited in M. Theodossiou, 'An analysis of the recent response of the Community to non compliance with Court of Justice judgments: Article 228(2) EC' (2002) 17 *European Law Review* 25, 36.

<sup>204</sup> As shown, the Commission enjoys wide powers of investigation and discrepancy in enforcing laws by coercion or the threat of hefty fines in competition law, whilst its powers on environmental matters are far more limited, see e.g. M. Cini, 'Administrative Culture in the European Commission: The Cases of Competition and Environment' in Neill Nugent (ed), *At the Heart of the Union: Studies of the European Commission* (Palgrave Macmillan 2000).

Ultimately, the extent to which the State is deterred in positive EU law may just be the by-product of the type of federalism pursued and of the extent to which it is accepted that the EU can ‘commandeer’ its Member States.<sup>205</sup>

The reader at this stage may be left with the impression that higher (or equivalent) fines should be imposed on the State in environmental law along the lines followed with regard to firms in competition law. This is certainly a straightforward prescription but it is not our conclusion. Instead, we suggest that some aspects of the existing soft deterrence paradigm shall be open to discussion. Those include responsiveness of States to economic sanctions, methodology used by the Commission and the Court for their determination, admissibility of justifications and defences, adjudication versus self-executing framework for deterrence, and ultimate destination of fines collected from Member States and firms.<sup>206</sup>

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<sup>205</sup> For instance, Halberstam argues that it is not Union action that ‘commandeers’ Member State legislative or administrative bodies but EU legislative activity that impacts the legal systems of the Member States. D. Halberstam, ‘Comparative Federalism and the Issue of Commandeering’ in Kalypso Nicolaidis and Robert Howse (eds), *The Federal Vision: Legitimacy and Levels of Governance in the United States and the European Union* (Oxford University Press 2007) 213. The soft, or cooperative approach toward the Member State illustrated in this article may be regarded to fall in line with cooperative federalism, which according to Schütze signifies the idea of complementary competences and the decline of exclusivity, see R. Schütze, *From Dual to Cooperative Federalism: The Changing Structure of European Law* (Oxford University Press 2009). Indeed, federalism, as discussed by Beaud, is created in order to safeguard the Member States, which he discusses the idea vocalised by James Bryce on federalism, encompassed as: ‘Créer une nation, tout en préservant les États’ O. Beaud, *Théorie de la Fédération* (Presses Universitaires de France 2007) 278.

<sup>206</sup> Peers makes the related argument that rather than simply incorporating the fines collected pursuant to Article 260 TFEU as revenue for the *overall* EU budget, the Commission should give that money to the Member States that comply with EU law by means of a reduction in their gross contributions to the EU budget, see S. Peers, ‘Sanctions for Infringement of EU Law after the Treaty of Lisbon’ (n 183) 63-64.